Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-331

ELMER E. MILLS,

Petitioner,

vs.

THE ELECTRIC AUTO-LITE COMPANY,
MERGENTHALER LINOTYPE CO.
and AMERICAN MANUFACTURING CO., INC.,

Respondents.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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APPENDIX A

In the

United States Court of Appeals

For the Seventh Circuit

Nos. 75-1558, 75-1559

ELMER E. MILLS and LOUIS SUSMAN,

Plaintiffs-Appellants, Cross-Appellees,

v.

THE ELECTRIC AUTO-LITE COMPANY, MERGENTHALER LINOTYPE COMPANY, and AMERICAN MANUFACTURING COMPANY,

Defendants-Appellees, Cross-Appellants.

Appeals from the United States District Court for the Northern District of Illinois, Eastern Division.
No. 63 C 1138—**James B. Parsons**, *Judge.*

ARGUED APRIL 6, 1976—DECIDED APRIL 7, 1977

Before SWYGERT and CUMMINGS, *Circuit Judges*, and JAMESON, *Senior District Judge.*[1]

SWYGERT, *Circuit Judge.* The principal issue in this appeal is whether the terms of a merger between Mergenthaler Linotype Company ("Mergenthaler") and the Electric Auto-Lite Company ("Auto-Lite") were fair to Auto-Lite's minority shareholders. We hold that the merger terms were fair and reverse the judgment of the district court.

[1] The Honorable William J. Jameson, United States Senior District Judge for the District of Montana, is sitting by designation.

I

This is the second time that this case has come before us. In order to place this appeal in its proper perspective, we will briefly review the case's history.

Prior to 1960 Auto-Lite primarily manufactured automotive parts and equipment. Because of changes in the automobile industry in the late 1950's, the continuation of its traditional business was threatened and it began a program of diversification into other industries. Nonetheless, in 1963 a substantial percentage of its sales remained tied to the automobile industry.

Mergenthaler produced and distributed typesetting equipment. It began to purchase Auto-Lite stock in 1957 and by March 1962 had acquired 54.2 percent of Auto-Lite. At that point Auto-Lite became a subsidiary of Mergenthaler and Mergenthaler obtained control of the Auto-Lite Board of Directors.

In early 1963 Mergenthaler decided to attempt a merger of itself and Auto-Lite into a new company to be called "Eltra Corporation." The Auto-Lite Board voted to accept the proposed merger on May 28, 1963 and on May 29 a request for proxies was sent to shareholders accompanied by a statement in which the Board endorsed the merger. The holders of approximately thirteen percent of the minority shares had to approve the merger in order to secure the two-thirds vote necessary for ratification. The merger was approved at a shareholders' meeting on June 27, 1963 and became effective on June 28, 1963.

Plaintiffs, who were Auto-Lite shareholders representing themselves and all other minority Auto-Lite shareholders, filed suit on June 26, 1963 in the district court for the Northern District of Illinois. They sought to set aside the merger on the ground that the proxy statement was deceptive because it endorsed the merger without clearly disclosing that the Auto-Lite Board was controlled by Mergenthaler. The district court agreed with plaintiffs' theory and held that the proxy statement violated section 14(a) of the Securities Exchange Act of 1934. It also held that the plaintiffs had shown a causal

relationship between the proxy statement and the consummation of the merger. 281 F. Supp. 826 (N.D. Ill. 1967).

This court affirmed the district court's holding that the proxy statement was illegally deceptive but reversed on the causality issue, holding that no relief could be appropriate if the defendants could show "by a preponderance of probabilities" that the merger would have been approved even if the proxy statement had not been deceptive. 403 F.2d 429, 436 (7th Cir. 1968).

The Supreme Court reversed and reinstated the judgment of the district court. It held that "[w]here there has been a finding of materiality, a shareholder has made a sufficient showing of causal relationship between the violation and the injury for which he seeks redress if, as here, he proves that the proxy solicitation itself, rather than the particular defect in the solicitation materials, was an essential link in the accomplishment of the transaction." 396 U.S. 375, 385 (1970).

The Court went on to consider the relief to which plaintiffs were entitled. It noted that the merger did not need to be set aside because of the deception in the proxy statement, though a court could order such action if it were warranted by equitable considerations. It then discussed the possibility of monetary relief and stated:

> [W]here, as here, the misleading aspect of the solicitation did not relate to terms of the merger, monetary relief might be afforded to the shareholders only if the merger resulted in a reduction of the earnings or earnings potential of their holdings. In short, damages should be recoverable only to the extent that they can be shown. If commingling of the assets and operations of the merged companies makes it impossible to establish direct injury from the merger, relief might be predicated on a determination of the fairness of the terms of the merger at the time it was approved. These questions, of course, are for decision in the first instance by the District Court on remand, and our singling out of some of the possibilities is not intended to exclude others. 396 U.S. at 388-89.

Finally, the Court held that the plaintiffs were entitled to be reimbursed by the corporation for litigation expenses and reasonable attorneys' fees.

The case then moved back to the district court for a determination of the appropriate relief. The court first held that the merger should not be rescinded. It then determined that the merger terms were unfair to plaintiffs and awarded the class they represent $1,233,918.35, as well as approximately $740,000 in prejudgment interest. It further held that plaintiffs' attorneys should be compensated out of this award.

Both parties now appeal from the district court's judgment. Plaintiffs contend that the amount of damages was too low and that their attorneys' fees should be assessed against defendants rather than against the damages awarded. Defendants assert that no damages should have been awarded because the terms of the merger were fair.

II

The district court considered two possible theories of damages in attempting to follow the Supreme Court's mandate: (1) to compensate plaintiffs for the reduction of the earnings potential of their holdings in Auto-Lite as a result of the merger; or (2) an award based on a determination of the fairness of the terms of the merger at the time it was approved. It rejected the use of the first theory under the circumstances of this case and adopted the second. We shall evaluate both whether the district court was erroneous in its choice of remedies and whether it correctly applied the second theory.

In order to perform this evaluation, it is first necessary to describe the merger terms. They called for the minority Auto-Lite shareholders to receive 1.88 preferred shares of Eltra for each share of Auto-Lite common that they held and the Mergenthaler shareholders to receive one common share of Eltra for each share of Mergenthaler common that they held. Eltra preferred shares were convertible into common shares on a one-to-one basis for the first two years following the merger and on a slightly decreasing basis

for the next three years.[2] At the time of the merger Mergenthaler common paid a dividend of $1 per share and Auto-Lite common paid a dividend of $2.40 per share. Under the merger terms Eltra common was to pay a dividend of $1 per share and Eltra preferred a dividend of $1.40 per share. The dividend received by the Auto-Lite minority shareholders was therefore increased as a result of the merger by twenty-three cents for each share of Auto-Lite that they had held, because 1.88 x $1.40 = $2.63.

The preferred Eltra stock was clearly worth more than Eltra common because it paid a higher dividend and represented a more secure investment if the new corporation encountered financial difficulties, yet was convertible into common stock. During the month following the merger, the average market value of Eltra preferred was $31.06 per share. Consequently the Auto-Lite minority shareholders received stock worth $58.39 on the market for each share of Auto-Lite that they had previously held, because 1.88 x $31.06 = $58.39. The average market value of Eltra common for this month was $25.25 per share. Since the Mergenthaler shareholders received one share of Eltra common for each share of Mergenthaler common, the Auto-Lite shareholders received stock for each share of Auto-Lite that they held worth $58.39/$25.25 = 2.31 times as much on the market as the stock that the Mergenthaler shareholders received for each share of Mergenthaler that they held. We therefore hold that the exchange ratio for the merger was effectively 2.31 to 1.[3]

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[2] In the third, fourth, and fifth years following the merger, one share of Eltra preferred was convertible into .955, .910, and .865 shares respectively of Eltra common.

[3] The district court, after considering the factors we have just reviewed, found the effective exchange ratio to be 2.25 to 1. Although the court never explained precisely how it arrived at this figure, the difference of .06 between the two ratios will not prove to be significant in subsequent calculations.

III

A theory of damages based on the "reduction of the earnings or earnings potential" of the Auto-Lite minority shareholders caused by the merger is an attempt to discern, by looking at the postmerger performance and activities of the Auto-Lite subsidiary in comparison to the other components of Eltra, whether the value placed on the Auto-Lite shares at the time the merger took place was fair to those shareholders. Plaintiffs contend that the postmerger record of Eltra demonstrates the unfairness of the merger in two significant ways: first, by showing that Eltra appropriated for use in its other divisions liquid assets held by Auto-Lite prior to the merger; and second, by showing that Eltra continually siphoned off Auto-Lite's postmerger earnings.

Even if plaintiffs' assertions are true, they cannot form the basis for an award of damages. Plaintiffs assume that it would be unfair to the former minority Auto-Lite shareholders if, after the merger, the Eltra management "weakened" the Auto-Lite divisions by shifting liquid assets or earnings to other divisions. This assumption is incorrect. After the merger the former Auto-Lite shareholders had become Eltra shareholders and had no more interest in the Auto-Lite divisions than any other Eltra shareholder. Therefore, they could not be injured by intra-corporate transfers of assets designed to strengthen the corporation as a whole. The interests of the former Auto-Lite shareholders and former Mergenthaler shareholders coincided after the merger, and the Eltra management could not possibly take actions that benefitted "its" shareholders at the expense of the Auto-Lite shareholders.

Plaintiffs rely heavily on *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1975); *Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281 (2d Cir. 1973); and *Janigan v. Taylor*, 344 F.2d 781 (1st Cir.), *cert. denied*, 382 U.S. 879 (1965), to support their theory of postmerger damages. They contend that under these decisions the defendants must be compelled to disgorge any "profits" realized as a consequence of the deceptive proxy statement and that those profits should be measured by the

sum of assets which moved from Auto-Lite to the other divisions of Eltra following the merger. However, plaintiffs misconceive the holdings of these cases. The cases all involved situations where defendants had realized demonstrable profits, at the expense of plaintiffs, through misrepresentation. Under such circumstances all three courts permitted a postmerger valuation of property which plaintiffs had been fraudulently induced to sell. But whether the exchange of Auto-Lite stock for Eltra stock profited Mergenthaler at the expense of the Auto-Lite minority shareholders is precisely the issue we are trying to resolve. Damages must be based on evidence that the Auto-Lite minority shareholders were not paid a fair price and the fact that Eltra shifted assets away from Auto-Lite following the merger is not satisfactory evidence of unfairness at the time the merger was consummated.

Plaintiffs ignored the only theory on which relief based on the postmerger performance of Eltra might be granted. If the ratio of the postmerger earnings of the Auto-Lite subsidiary of Eltra to the postmerger earnings of the Mergenthaler subsidiary were unusually high given the terms of the merger, it would be evidence that those terms were unfair to the Auto-Lite minority shareholders. This is true not because the former Auto-Lite minority shareholders are entitled to any percentage of the earnings of the Auto-Lite subsidiary after the merger, but because a high ratio would indicate that in retrospect the merger terms underestimated Auto-Lite's value as an enterprise.

Eltra's financial records show that for the ten year period beginning in 1963 and ending in 1972 the Auto-Lite divisions earned $122,501,632 while the Mergenthaler divisions earned $58,827,595. Before the merger Auto-Lite had 1,159,265 shares outstanding while Mergenthaler had 2,698,822 shares outstanding. Arguably, therefore, Auto-Lite would have had average yearly earnings per share of $10.57 between 1963 and 1972 if there had been no merger because its average yearly earnings would be $122,501,632/10 = $12,250,163 and $12,250,163/1,159,265 = $10.57. By the same reasoning, Mergenthaler's average yearly earnings per share

for the same period would be $2.18 because $58,827,595/10 = $5,882,759 and $5,882,759/2,698,822 = $2.18. The ratio of $10.57 to $2.18 is 4.85, indicating that the actual effective exchange ratio of 2.31 underestimated the value of Auto-Lite in comparison to Mergenthaler.

An award of damages based on the comparative postmerger earnings of Auto-Lite and Mergenthaler, however, depends upon the assumption that the two subsidiaries continued to function independently after the merger was consummated. If the assets or operations of the two subsidiaries were commingled, it would be improper to utilize the postmerger performance of either one as evidence that at the time of the merger Auto-Lite was a stronger company than the merger terms indicated, because Auto-Lite's increase in earnings following the merger might have been the result of input from Mergenthaler that it would not have received without the merger.

The district court held that there was substantial commingling of the assets and operations of Auto-Lite and Mergenthaler during the period following the merger. It found that the plaintiffs' statistics failed to measure the change in the quality of management that flowed to the Auto-Lite divisions of Eltra as a consequence of the merger or the economies of scale that the merger produced. It also found the statistics to be misleading because the postmerger Eltra statements underestimated the expenses of the Auto-Lite divisions, making the earnings of those divisions appear higher than they really were. These findings are supported by substantial evidence and we affirm them.

Given the fact that significant commingling occurred, the postmerger earnings of Auto-Lite and Mergenthaler cannot supply a reliable guide to whether the merger terms were fair to the Auto-Lite minority shareholders. Even in the absence of commingling, postmerger evidence can only create a rebuttable inference of unfairness because it is impossible to know with certainty whether the increase in earnings of one partner to a merger should have been predictable at the time the merger took place. In this case the ratio of the earnings per share of the two companies for the four years prior to and including 1963 were all at or below the effective

exchange ratio of 2.31 to 1.[4] Plaintiffs have not shown that the management of Mergenthaler should have known in 1963 that Auto-Lite's earnings were going to increase faster than Mergenthaler's during the next decade. The more plausible inference is that, insofar as Auto-Lite's business became more productive because of factors unrelated to commingling, they were unforeseeable at the time the merger was consummated. Accordingly, we hold that the district court did not abuse its discretion in refusing to award damages based on postmerger data.

IV

A.

The district court based its award of damages on an assessment of the fairness of the merger terms at the time the merger took place. It evaluated five criteria in making this assessment: (1) the market value of each corporation's stock; (2) each corporation's earnings; (3) the book value of each corporation's assets; (4) the dividends that each corporation paid on its stock; and (5) other "qualitative factors" indicating the strength of each corporation. The court found market value to be an unreliable criterion and discounted the importance of dividends. It found that the comparative earnings and book values of each corporation were significant and demonstrated that the merger terms were unfair to the Auto-Lite minority. The court did not indicate what significance it was attributing to "qualitative factors."

Based on these findings the court held that the merger would have been fair if the Auto-Lite minority shareholders had received the equivalent of 2.35 shares of Eltra common for each share of Auto-Lite that they held and Mergenthaler shareholders had received one share of Eltra common for each share of Mergenthaler

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[4] Plaintiffs assert that the ratio of Auto-Lite's earnings per share to Mergenthaler's earnings per share was 2.2 in 1960, 1.0 in 1961, 1.5 in 1962, and 2.33 in 1963. Defendants assert that the ratio was 1.0 in 1961, 1.27 in 1962, 1.79 in the fiscal year 1963, and 1.90 in the calendar year 1963. They do not provide figures for 1960.

that they held. It also found that the effective exchange ratio for the actual merger, where the Auto-Lite minority shareholders received 1.88 shares of Eltra preferred for each share of Auto-Lite common that they held, was 2.25 to 1 in terms of Eltra common.[5] It then awarded damages of $1,233,918.35 to plaintiffs based on the differential of .10 between the effective exchange ratio of 2.25 to 1 and the fair exchange ratio of 2.35 to 1.[6]

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[5] *See* note 3 *supra*.

[6] The district court used the following method of reaching the figure of $1,233,918.35:

(1) Since each share of Auto-Lite was exchanged for the equivalent of 2.25 shares of Eltra common while each share of Mergenthaler was exchanged for one share of Eltra common, the holder of one share of Auto-Lite received 67.38 percent of the interest in Eltra distributed for one share of Auto-Lite and one share of Mergenthaler, because 2.25/(2.25 + 1) = .6738.

(2) If a fair exchange ratio of 2.35 had been employed, the holder of one share of Auto-Lite would have received 70.15 percent of the interest in Eltra distributed for one share of Auto-Lite and one share of Mergenthaler, because 2.35/(2.35 + 1) = .7015.

(3) Since 70.15-67.38 = 2.77, the Auto-Lite minority shareholders were unfairly deprived of 2.77 percent of the combined value of an Auto-Lite share and a Mergenthaler share for each share of Auto-Lite that they held.

(4) In July 1963, the month following the merger, the average market value of the Eltra stock that was distributed for one share of Mergenthaler was $25.25 and the average market value of the Eltra stock that was distributed for one share of Auto-Lite was $58.39. Accordingly, the combined value of one share of Mergenthaler and one share of Auto-Lite was $25.25 + $58.39 = $83.64.

(5) 2.77 percent of $83.64 is $2.317. Since there were 532,500 minority shares of Auto-Lite, the total damages were 532,500 x $2.317 = $1,233,918.35.

The district court's method of calculation was mathematically unsound. First, there was an arithmetic error in step one because 2.25/(2.25 + 1) is .6923 rather than .6738. The more fundamental error, however, lies in the court's premise in steps 3, 4, and 5 that the 2.77 percent figure could be multiplied by the combined market value of one share of Auto-Lite and one share of Mergenthaler to calculate the per

(Footnote continued on following page)

B.

The district court discounted the significance of the comparative market values of Auto-Lite and Mergenthaler stock during the five year period preceding the merger because it found that purchases of Auto-Lite stock by Auto-Lite itself and by Mergenthaler, and of Mergenthaler stock by the American Manufacturing Company,[7] made market value an unreliable indicator during that period of the true worth of the two

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[6] *continued*

share dollar loss which the Auto-Lite shareholders had suffered. It is circular reasoning to use the market value generated by the actual merger. If a different exchange ratio had been employed, the market value of Eltra stock undoubtedly would have been different. Moreover, the mathematical significance of the 2.77 percent figure is questionable.

What the court should have done, if its differential of .10 were correct, was simply multiply the differential by the number of minority Auto-Lite shares to calculate the number of additional Eltra common shares that should have been distributed to plaintiffs to make the merger terms fair.

[7] Auto-Lite purchased 579,883 of its own shares in 1960-61, 31,500 shares in 1962, and 4,900 shares in 1963 before May 24. Mergenthaler purchased 212,600 shares of Auto-Lite between February 1957 and the end of 1958, and an additional 167,350 shares in 1959. It owned 408,950 shares by May 24, 1960. After Auto-Lite purchased some of its own shares in August 1961, Mergenthaler's holdings constituted approximately thirty-four percent of Auto-Lite. In March 1962 Mergenthaler purchased an additional 219,065 shares of Auto-Lite, increasing its holdings to approximately fifty-four percent of Auto-Lite's stock.

American had 43,100 shares of Mergenthaler prior to 1958. By December 1960 it had increased its holdings to 190,834 shares, which became 763,336 shares after a 4 for 1 stock split in March 1961. It purchased an additional 108,073 shares in 1962 and 12,700 shares in 1963 before May 24. Its holdings in Mergenthaler at the time of the merger constituted approximately thirty-three percent of Mergenthaler's stock. American also purchased an additional 2,800 shares of Mergenthaler between May 27 and June 14, 1963. However, these purchases are irrelevant because the final comparison of the market value of Auto-Lite and Mergenthaler stock used in setting the merger terms was made on May 24, 1963.

parties to the merger. Defendants challenge the district court's assessment while plaintiffs contend that it was correct, at least for the period after 1960. We agree with defendants.

The district court's holding depends upon the validity of two premises: first, that the inter- and intra-company purchases substantially affected the market value of either corporation's stock immediately prior to the merger and second, that any effect which these purchases did have caused the price of Auto-Lite stock to fall relative to the price of Mergenthaler stock.[8] We find neither premise to be supported by the evidence. The great portion of the inter- and intra-company purchases took place before the six month period immediately preceding the merger, and the effect of those purchases during that period was negligible.[9] There was no manipulation of stock prices immediately before the merger by any of the companies involved in an effort to secure more favorable merger terms. Moreover, the price ratio of the two stocks was the same during 1961 and 1962, when there were substantial purchases by Auto-Lite, Mergenthaler, and American, and the first

[8] Since defendants contend that market value should be used to measure the fairness of the merger terms, we need not be concerned with whether the purchases in question adversely affected the price of Mergenthaler stock relative to Auto-Lite stock.

[9] *See* note 7 *supra*. Auto-Lite's purchases of 4,900 shares of its own stock in 1963 up to May 24 constituted 8.2 percent of the 59,900 shares of Auto-Lite traded on the New York Stock Exchange during that period, and .42 percent of the 1,160,565 shares of Auto-Lite outstanding. American's purchases of 12,700 shares of Mergenthaler stock in 1963 up to May 24 constituted 6.3 percent of the 201,200 shares of Mergenthaler traded on the New York Stock Exchange during that period and .47 percent of the 2,698,822 shares of Mergenthaler outstanding. Mergenthaler acquired no Auto-Lite stock between March 1962 and the time of the merger.

half of 1963, when there were not.[10] This is a strong indication that the price of both corporations' stock was responding to factors other than these transactions.

Even if we assume that the purchases had an effect, it is difficult to see how it could be detrimental to the price of Auto-Lite relative to the price of Mergenthaler. Since all of the transactions at issue were purchases, they would have tended to raise rather than lower the price of the stock that was traded. But there was a greater volume of Auto-Lite stock purchases by Auto-Lite itself and by Mergenthaler than of Mergenthaler purchases by American.[11] Second, during the eighteen months prior to the merger the ratio of the inter- and intra-company purchases of Auto-Lite to the total amount of Auto-Lite stock traded was greater than the ratio of American's purchases of Mergenthaler to the total amount of Mergenthaler stock traded.[12] Finally, a greater proportion of the Auto-Lite purchases took place

[10] The ratio of the average price of Auto-Lite stock to the average price of Mergenthaler stock was 2.0 in 1961, 2.1 in 1962, and 2.1 in 1963 up to May 24, the last date on which the prices were compared for purposes of the merger.

[11] The best evidence of this is the simple statistic that at the time of the merger Mergenthaler held approximately fifty-four percent of Auto-Lite's stock while American held approximately thirty-three percent of Mergenthaler's stock. Mergenthaler purchased all of its Auto-Lite shares after February 1957 while American purchased all but 2,000 of its Mergenthaler shares after June 1956. Therefore, Mergenthaler acquired its interest in Auto-Lite during roughly the same period that American acquired its interest in Mergenthaler, indicating that during this period the inter- and intra-company purchases of Auto-Lite stock constituted a greater percentage of the total amount of trading in that stock than did the inter-company purchases of Mergenthaler stock.

[12] In 1962 Mergenthaler acquired 219,065 shares of Auto-Lite through a tender offer to Auto-Lite shareholders and Auto-Lite itself purchased 31,500 shares out of the 171,300 shares traded on the New York Stock Exchange. In 1963 up to May 24 Auto-Lite purchased 4,900 of its shares out of the 59,900 shares traded on the New York Stock Exchange. Therefore, the inter- and intra-company transactions in Auto-Lite represented 56.7 percent of the total transactions in Auto-Lite during this period.

(Footnote continued on following page)

in the period between 1961 and 1963, when they were likely to have a more substantial effect on price than earlier purchases.[13] The combination of these three factors indicates that the inter- and intra-company purchases pushed the price of Auto-Lite stock upward relative to Mergenthaler stock rather than producing the opposite effect.

We therefore hold that the inter- and intra-company transactions did not unfairly distort the relative market prices of Auto-Lite and Mergenthaler for purposes of determining the fairness of the merger. We must now decide what period of time should be used in calculating a price ratio between each corporation's stock. Since prices from the period immediately preceding the merger are the most likely to reflect the actual value of each corporation at the time the merger was consummated, we begin with a presumption that a short period is appropriate. Accordingly, we hold that the average market value for approximately the six month period preceding the merger should be used unless there are special factors indicating that this period is unreliable. Six months is long enough so that very short term price fluctuations will not play an unfairly important role and

[12] *continued*

In 1962 American purchased 103,073 shares of Mergenthaler out of the 522,900 shares traded on the New York Stock Exchange. In 1963 American purchased 12,700 shares of Mergenthaler out of 201,200 shares traded on the New York Stock Exchange. Therefore, American purchased 16.0 percent of the Mergenthaler stock sold during this period.

[13] Auto-Lite purchased 270,355 of its own shares in 1958-60 and 345,793 of its own shares in 1961-63. Mergenthaler purchased 282,550 shares of Auto-Lite in 1958-60 and 219,065 additional shares in 1961-63. Thus, the distribution of inter- and intra-company transactions in Auto-Lite between these two periods was roughly equal.

American purchased 147,734 shares of Mergenthaler in 1958-60 which became 590,936 shares after a 4 for 1 stock split. It purchased 139,766 shares of Mergenthaler in 1961-63. Thus, the great proportion of the inter-company trading in Mergenthaler was prior to 1961.

short enough so that the calculated ratio does not reflect business conditions that have substantially changed as of the time of the merger.

In this case the ratio between the average price of Auto-Lite and the average price of Mergenthaler during 1963 prior to the formulation of the merger terms in late May was 2.1. Our confidence that this figure accurately reflects the relative worth of the two corporations is bolstered by the fact that the ratio for 1962 was also 2.1 and was 2.0 for 1961. The similarity of these numbers is evidence that the ratio immediately preceding the merger was not the result of a short term anomaly caused either by the merger itself or by other factors.

Plaintiffs argue, however, that market prices were an unreliable indicator of the true worth of Auto-Lite and Mergenthaler between 1961 and 1963 but did provide a valid measure of each corporation's value between 1958 and 1960. We find these arguments to be unpersuasive. Plaintiffs first assert that Mergenthaler used its control over Auto-Lite in 1961-63 to compel it to pay unusually high dividends, with the effect of depressing the price of Auto-Lite stock by draining Auto-Lite of capital and raising the price of Mergenthaler stock by giving Mergenthaler funds with which to pay higher dividends. This reasoning is inconsistent. If the payment of higher dividends by Mergenthaler increased the value of Mergenthaler stock, it would follow that the payment of high dividends by Auto-Lite increased the attractiveness of Auto-Lite stock on the market. There is no reason to believe that a reduction in the Auto-Lite dividend would have resulted in raising the price of Auto-Lite stock. It is more likely that such a dividend reduction would have decreased the value of each corporation's stock. Accordingly, we hold that Auto-Lite's high dividends between 1961 and 1963 did not unfairly distort the relative market values of Auto-Lite and Mergenthaler.

Plaintiffs also urge that market prices between 1958 and 1960 provided a more accurate picture of each corporation's actual value than prices during the later period because a substantial change in the nature of

Auto-Lite's business following 1960 temporarily depressed the price of its stock. We find this to be an argument for using the later prices rather than the earlier ones. The fact that Auto-Lite's traditional business was eroding by 1961 renders unreliable market values based on that business. In 1961 the market began to reflect the uncertainty in Auto-Lite's future which most observers perceived. That uncertainty remained at the time of the merger and should properly have been a factor in determining the merger terms.[14]

C.

After finding that market value provided an inaccurate measure of the true worth of Auto-Lite and Mergenthaler, the district court determined whether the merger terms were fair on the basis of comparative earnings and book value. Given our conclusion that market prices were an accurate gauge of actual value, we must decide whether the other criteria on which the district court relied should properly be considered in evaluating whether the merger was fair.

We hold that when market value is available and reliable, other factors should not be utilized in determining whether the terms of a merger were fair. Although criteria such as earnings and book value are an indication of actual worth, they are only secondary indicia. In a market economy, market value will always be the primary gauge of an enterprise's worth. In this case thousands of shares of Auto-Lite and Mergenthaler were traded on the New York Stock Exchange during the first part of 1963 by outside investors[15] who had access to the full gamut of financial information about both corporations, including earnings and book value. If we were to independently assess criteria other than market value in our effort to determine whether the merger terms were fair, we would be substituting our

[14] Another reason why we cannot accept plaintiffs' assertion that the 1958-60 prices were reliable while the 1961-63 prices were not is that there were more inter- and intra-company transactions during the earlier period than during the latter.

[15] *See* note 9 *supra*.

abstract judgment for that of the market. Aside from the problems that would arise in deciding how much weight to give each criterion, such a method would be economically unsound.

D.

We turn now to a determination of whether the merger terms were fair, based on the comparative market price of each corporation's stock during the first part of 1963. The simplest method of resolving this issue would be to compare the price ratio, in this case 2.1, to the effective exchange ratio, which we have previously established as 2.31. Under this framework the merger would be fair since the effective exchange ratio gave the Auto-Lite minority shareholders more Eltra stock than they were entitled to in the judgment of the market.

This method of calculation, however, assumes that the new corporation that results from a merger is worth exactly as much as the sum of what its two component parts were worth before the merger. As Professors Brudney and Chirelstein have cogently pointed out, this assumption is usually false because a merger produces a synergistic effect resulting in the merged corporation being worth more than the sum of the two old corporations. Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 Harv. L. Rev. 297, 308-09 (1974). They demonstrate that fairness requires that minority shareholders be compensated not only for the market value of their shares in the old corporation but also for the share of the synergism generated by the merger that is proportionate to the interest that those shares represented in the combined premerger value of the two old corporations. *Id.* at 313-25.

We adopt the approach formulated by Professors Brudney and Chirelstein and will attempt to apply it to this case. At the time of the merger there were 532,550 minority shares of Auto-Lite and 2,698,822 shares of Mergenthaler outstanding. During the first part of 1963 the average market price of Auto-Lite was $52.25 per share and the average market price of Mergenthaler

was $24.875 per share. Thus, the premerger value of the minority holdings in Auto-Lite was 532,550 x $52.25 = $27,825,737 and the premerger value of Mergenthaler was 2,698,822 x $24.875 = $67,133,197. The combined premerger value of the two corporations was $27,825,-737 + $67,133,197 = $94,958,934.[16]

In the month following the merger, Eltra common stock had an average market value of $25.25 per share. Eltra preferred stock had an average market value of $58.39 per 1.88 shares, the amount of stock which Auto-Lite shareholders had received for each share of Auto-Lite that they had held. The postmerger value of Eltra was therefore (2,698,822 x $25.25) + (532,550 x $58.39) = $68,145,255 + $31,095,594 = $99,240,849. The difference between the combined premerger value of Auto-Lite and Mergenthaler and the postmerger value of Eltra, which was $99,240,849 – $94,958,934 = $4,281,915, can be attributed to the synergism generated by the merger.

According to the fairness formula devised by Professors Brudney and Chirelstein, the minority shareholders of Auto-Lite should have received Eltra stock worth at least as much as the premerger market value of their holdings in Auto-Lite and a share of the synergism produced by the merger proportionate to the percentage of the combined premerger value of Auto-Lite and Mergenthaler which their hoidings represented. The premerger value of the Auto-Lite minority shares was $27,825,737, which represented 29.3 percent of $94,958,934, the combined premerger value of Auto-Lite and Mergenthaler. Thus, to satisfy the constraints of fairness, the Auto-Lite minority shareholders should have received stock worth at least $27,825,737 + (.293 x $4,281,915) = $29,080,338. This would be equivalent to 1,151,696.5 shares of Eltra common at $25.25 per share. Had this many shares been distributed

[16] Although Mergenthaler owned more than half of the Auto-Lite stock, this holding should not be independently counted as part of the combined value of the two corporations because it was already reflected in the value of Mergenthaler stock.

to the Auto-Lite minority shareholders, the exchange ratio would have been 1,151,696.5/532,550 = 2.16 to 1.[17]

The Auto-Lite minority shareholders actually received preferred stock worth $58.39 on the market for each share of Auto-Lite that they had held. As a group, their Eltra holdings were worth 532,550 x $58.39 = $31,095,-594. This was $31,095,594 – $29,080,338 = $2,015,256 more than fairness required. This result can be expressed in terms of Eltra common shares. Since the effective exchange ratio of the merger was 2.31 to 1, the property given the Auto-Lite minority was worth 2.31 – 2.16 = .15 shares of Eltra common per share of Auto-Lite more than what a fair amount would have been.

We therefore hold that the terms of the merger were fair and that plaintiffs should recover no damages. A numerical example may help to show the justice of this result. In early 1963, an Auto-Lite shareholder with one hundred shares and a Mergenthaler shareholder with 210 shares each owned stock worth approximately $5225. After the merger, the former Auto-Lite shareholder had 188 shares of Eltra preferred worth approximately $5839 while the former Mergenthaler shareholder had 210 shares of Eltra common worth approximately $5302. Both individuals benefitted from the merger, but the former Auto-Lite minority shareholder benefitted more.

V

The district court held that plaintiffs should recover their attorneys' fees and other litigation expenses out of the damages which the court awarded them. Since we

[17] We note that the price of Eltra common depended in part on the exchange ratio actually used. For example, if we assume that Eltra stock was distributed at an effective exchange ratio of 2.16 to 1, there would have been the equivalent of 2,698,822 + (2.16 x 532,550) = 3,849,130 Eltra common shares outstanding. Since the total postmerger value of Eltra was $99,240,849, the price of one share of Eltra common would rise to $99,240,849/3,849,130 = $25.78. However, the figures in the text give a good approximation of the number of Eltra common shares or their equivalent that the Auto-Lite minority shareholders should have received.

have found that plaintiffs were treated fairly in the merger and are not entitled to damages, we must face the question of whether and how much they nonetheless should be compensated by Eltra for their fees and expenses.

When this case was before the Supreme Court, the Court held "that petitioners, who have established a violation of the securities laws by their corporation and its officials, should be reimbursed by the corporation or its survivor for the costs of establishing the violation." 396 U.S. at 389 (footnote omitted). The Court later stated that "[w]hether petitioners are successful in showing a need for significant relief may be a factor in determining whether a further award should later be made. But regardless of the relief granted, private stockholders' actions of this sort 'involve corporate therapeutics,' and furnish a benefit to all shareholders by providing an important means of enforcement of the proxy statute." *Id.* at 396 (footnotes omitted).

We interpret this language to mean that plaintiffs should recover from Eltra all fees and expenses related to the establishment of a violation of the federal securities laws. This would encompass the litigation through the decision in the Supreme Court. The Court has indicated that the award is not contingent upon the existence of a fund created from any damages eventually awarded the plaintiffs.[18]

The Court left open the question of whether plaintiffs should also be compensated for fees and expenses incurred in a trial and subsequent appeals on the issue of damages, implying that whether or not plaintiffs obtained damages should be a factor in resolving that question. We hold that plaintiffs are not entitled to be compensated for fees and expenses they have incurred since the Supreme Court's decision in this case. In *Alyeska Pipeline Co. v. Wilderness Society*, 421 U.S. 240 (1975), the Supreme Court held that, absent statutory

[18] In its most recent decision dealing with the issue of fee-shifting, the Court by implication approved its earlier reasoning in *Mills*. *See Alyeska Pipeline Co. v. Wilderness Society*, 421 U.S. 240, 257-58 (1975).

authority, the only exceptions to the general American rule that a litigant must pay his own fees and expenses are in situations where the litigant confers a common benefit on the class that he represents or where a losing party acts in bad faith. Since the Securities Exchange Act provides no authorization for fee-shifting in this type of case and the bad faith exception is inapposite here, plaintiffs cannot recover fees and expenses unless they demonstrate that their work on the issue of damages produced a common benefit for the former Auto-Lite minority shareholders. Plaintiffs cannot meet this burden. They have conferred no benefit upon the class they represent beyond the "corporate therapeutics" produced by their showing that the proxy statute was violated, and they must pay their own fees and expenses for their unsuccessful attempt to obtain damages for that violation.

The judgment of the district court is reversed and the cause is remanded for further proceedings consistent with this opinion.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

APPENDIX B

United States Court of Appeals

For the Seventh Circuit

June 3, 19 77

Before

Hon. LUTHER M. SWYGERT, Circuit Judge

Hon. WALTER J. CUMMINGS, Circuit Judge

Hon. WILLIAM J. JAMESON, Senior District Judge*

ELMER E. MILLS and LOUIS SUSMAN,
Plaintiffs-Appellants,
Cross-Appellees,

Nos. 75-1558 and 75-1559 vs.

THE ELECTRIC AUTO-LITE COMPANY, MERGENTHALER LINOTYPE CO. and AMERICAN MANUFACTURING CO., INC.,
Defendants-Appellees,
Cross-Appellants.

Appeals from the United States District Court for the Northern District of Illinois, Eastern Division

No. 63 C 1138
James B. Parsons, Judge

On consideration of the petition for rehearing and suggestion for rehearing in banc filed in the above-entitled cause by counsel for the plaintiffs, no judge in active service has requested a vote thereon, and all of the judges on the original panel have voted to deny a rehearing. Accordingly,

IT IS ORDERED that the aforesaid petition for rehearing be, and the same is hereby, DENIED.

* The Honorable William J. Jameson, United States Senior District Judge for the District of Montana, is sitting by designation.

Note: Circuit Judges Robert A. Sprecher and Philip W. Tone did not participate in any consideration of the petition.

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 63 C 1138

ELMER E. MILLS, et al.,

Plaintiffs,

v.

THE ELECTRIC AUTO-LITE COMPANY, et al.,

Defendants.

MEMORANDUM OPINION AND ORDER

This case arises from the merger of the defendant, The Electric Auto-Lite Company (hereafter "Auto-Lite"), with the defendant, Mergenthaler Linotype Company (hereafter "Mergenthaler"), which merger resulted in the formation of the Eltra Corporation (hereafter "Eltra"). This case involves the takeover of a large but uncertain corporation by a corporation one-third its size, but stable and certain. Auto-Lite's net sales during the five calendar years before the merger were, in millions of dollars, 184, 220, 221, 167 and 180; and its net income during those years was, in millions of dollars, 3, 8, 6, 3 and 3. On the other hand, the net sales of Mergenthaler during the four fiscal years prior to the merger were, in millions of dollars, 41, 39, 47 and 54; and its net income during those years was, in millions of dollars, 8, 3, 4 and 5.

Plaintiffs filed this lawsuit on June 26, 1963, the day before a scheduled special meeting of Auto-Lite shareholders at which the merger was to be considered. In their original complaint, plaintiffs complained, *inter alia*, that a Notice and Proxy Statement, dated May 29,

1963, was sent by Auto-Lite to its shareholders which was inadequate and illegal in that it failed to disclose the interrelationship between Auto-Lite and the defendants, Mergenthaler and the American Manufacturing Company (hereafter "American"). Plaintiffs asked that the merger agreement be declared void. Each of the plaintiffs claimed to own shares of Auto-Lite common stock and to be acting on their own behalf and on behalf of all other Auto-Lite shareholders similarly situated. They also claimed to be acting derivatively on behalf of Auto-Lite itself.

Shortly after the filing of this lawsuit, several important events occurred. On June 27, 1963, a vote in favor of the Auto-Lite and Mergenthaler merger was had at the Auto-Lite shareholders' meeting; on June 28, 1963, that merger became effective; and on February 4, 1964, the plaintiffs filed an amended and supplemental complaint which took into account these latest events.

The amended and supplemental complaint contained three counts. Count I charged common law fraud, and specifically alleged that prior to 1963 American and Mergenthaler devised a plan fraudulently to acquire all of Auto-Lite's assets and business at a grossly low price. Count II charged federal securities violations in that Mergenthaler caused Auto-Lite to send through the mails an intentionally misleading proxy statement. Count III charged the defendants with violations of the laws of Ohio in that the actions of Auto-Lite, an Ohio corporation, were *ultra vires*. All material allegations in each of the three counts were denied by the defendants in an answer filed on October 15, 1964.

On November 15, 1965, I granted plaintiffs' motion for partial summary judgment on Count II, holding that the merger proxy statement did not describe sufficiently the interrelationship between the Auto-Lite Board of Directors and Mergenthaler and American. On April 15 and June 8, 1966, I conducted hearings on the issue of causal connection between the improper proxy statement and the merger of Auto-Lite into Mergenthaler; thereafter, plaintiffs moved for a further order of

summary judgment on Count II, contending that the necessary causal connection had been shown. On September 26, 1967, I filed a memorandum opinion and order finding that the plaintiffs had established the defendants' liability on that Count and directing the parties to go forward on the issue of appropriate relief. This opinion is reported in *Mills v. Electric Auto-Lite*, 281 F.Supp. 826 (N.D. Ill. 1967). I concluded that the "proxy material, as a matter of law and fact, was a direct and ultimate cause of the merger of Auto-Lite and Mergenthaler." Two days later, I further stated that the merger, though effectuated by conduct in violation of § 14 of the Securities Exchange Act of 1934, was not automatically void. On October 4, 1967, I entered an order amending my earlier order to include a finding pursuant to 28 U.S.C. § 1292(b) that the granting of partial summary judgment on Count II in favor of the plaintiffs involved a controlling question of law. Defendants and plaintiffs appealed.

The Seventh Circuit Court of Appeals on November 25, 1968, reversed in part this Court's judgment of September 26, 1967 in *Mills v. Electric Autolite Company*, 403 F.2d 429 (7th Cir. 1968) and remanded the case. However, this decision was reviewed by the Supreme Court of the United States which vacated the judgment of the Court of Appeals for the Seventh Circuit and returned the case to proceed on with the matter of appropriate relief and related issues. *Mills v. Electric Auto-Lite*, 396 U.S. 375 (1970). The Supreme Court also found, on an issue that had not been raised before me, that the plaintiffs should be reimbursed by either Mergenthaler or Eltra for the costs of establishing the Section 14(a) violation; such costs include attorneys' fees and the reasonable expenses of litigation other than statutory costs incurred by the plaintiffs up to and including the date of the Supreme Court's decision. *Mills*, *supra*, at 389-397.

Since the 1970 Supreme Court decision, I have ruled on numerous matters, on some of which appeal has been sought, and I have conducted a trial in conformity with

the directions of the high court. The trial commenced on November 12, 1973 and concluded on February 19, 1974. Since then, each of the parties has submitted extensive post-trial briefs and reply briefs and each has pursued at least one new motion.

When the case was back before me, I proceeded to hear the issue of the form of relief, and on January 10, 1972, entered findings of fact and conclusions of law finding that rescission of the merger would not be an appropriate remedy. My opinion appears in CCH Fed. Sec. L. Rep. ¶ 93,354 (N.D. Ill. 1972). I then went into the class issue under Count II and on May 22, 1972, by memorandum opinion, established the class of potential plaintiffs to be those persons who had been Auto-Lite shareholders at the time of the merger and who have continuously retained stock interests in the Eltra Corporation arising from their stock in Auto-Lite since the merger. Specifically excluded from the class were persons who purchased shares in Eltra subsequent to the merger which purchases were independent of the stock transfers called for in the terms of the merger. Subsequently, notice forms were approved and mailed to potential class members. Plaintiffs sought to overturn various rulings on the class issue by mandamus, but these attempts failed. The plaintiffs have renewed motions seeking rescission of the merger and redefinition of the class, and these motions remain for final determination at this time.

The central issue at trial and in the post-trial briefs has been the nature and amount of relief, if any, for the defendants' violation of § 14(a), 15 U.S.C. § 78n(a). The violation was, as originally I had stated, that the proxy statement ". . . contained material omissions and partial disclosures which would mislead the shareholders of Auto-Lite." *Mills, supra,* 281 F.Supp. at 827. In approving this Court's finding of liability based upon the violation of § 14(a), the Supreme Court recognized that the question of relief was left open. It did, however, single out certain possible forms that relief might take, including equitable relief, such as the setting aside of

the merger, monetary relief based upon a reduction of earnings or earnings potential, and monetary relief predicated on a determination of the fairness of the merger terms at the time of approval. *Mills, supra,* at 386 and 389.

At trial, the plantiffs offered evidence on the two alternative measures of monetary relief specifically noted by the Supreme Court. Plaintiffs' expert, Dr. George H. Sorter of the University of Chicago, testified that from his examination of the defendants' own financial documents, he traced a direct injury of over $69,000,000 to all the former Auto-Lite minority shareholders (i.e., those who owned 46-47% of the Auto-Lite common stock at the time of the merger) based upon a reduction of their earnings or earnings potential as a result of the merger. Plaintiffs' expert, Dr. Erwin E. Nemmers of Northwestern University, testified that the merger terms were unfair as of the time of their approval and that the Auto-Lite minority shareholders suffered actual damages of over $52,000,000.

The defendants called the following witnesses on their behalf:

Gurdon W. Wattles, Chairman of Eltra; J. A. Keller, President of Eltra; Glenn E. Taylor, Eltra's Executive Vice President, Finance; Lawrence L. Garber, Vice Chairman of Eltra's Board and President of Prestolite at the time of the merger; James B. Barry, Eltra's Director of Planning; John F. Rittenhouse, President of C & D Battery Division of Eltra; Leo J. Flury, Manager of the Prestolite Division's Accounting Department; and James J. Petlow, and attorney in Eltra's Legal Department. Defendants also called the following expert witnesses: George V. Carracio, a Certified Public Accountant with Arthur Young & Robert Emmett, Executive Vice President of Standard Research Consultants; Professor James H. Lorie of the University of Chicago; and Michael J. Quinn, a Certified Public Accountant with Price Waterhouse & Co. In rebuttal plaintiffs presented the testimony of an attorney, Robert J. Peters.

At the trial's conclusion, defendants maintained that the Auto-Lite minority shareholders were treated fairly in the merger exchange and accordingly are entitled to no damages—notwithstanding the § 14(a) violation. Plaintiffs renewed their motions for rescission, and asked for the assessment of punitive damages. Besides recognizing possible forms of relief, the Supreme Court in *Mills, supra* at 369, also implicitly indicated that relief may be unavailable if actual injury could not be shown.

I shall address myself to not only the issue of damages, but as well to all other issues raised by the amended complaint and the various pending motions.

In analyzing the factual data with respect to relief, three matters require consideration. These are (1) the degree of control and/or ownership exercised by some of the parties to this dispute over others, (2) the relative position of the merging parties with respect to their industries as a whole and with respect to their past histories, and (3) the terms of the merger. My recitation of the facts reflects those uncontested facts which I find competent and material, and those I determine when applying the concept of "greater weight of the evidence."

(1) Control

The evidence shows that the defendant American began to acquire shares of stock in Mergenthaler in June, 1954, and had acquired 903,102 shares of Mergenthaler for an amount approaching $12 million by the time of the merger. The table below illustrates the cumulative number of Mergenthaler shares held by American during various times prior to the merger and the cumulative amount paid for such shares.

Month	Cumulative Shares	Cumulative Amount
June 1954	2,000	67,735.51
June 1956	43,100	2,010,587.97
June 1958	61,903	2,666,659.63
September 1958	65,103	2,788,637.01
June 1959	90,620	3,927,016.27
December 1960	190,834	8,694,362.66
March 1961 (4 for 1 stock split)	(190,834 x 4) 763,336	8,694,362.66
January 1962	774,970	8,821,853.23
May 1962	852,570	11,021,989.81
September 1962	865,729	11,121,637.43
January 1963	891,102	11,685,362.55
March 1963	893,102	11,735,050.40
April 22, 1963	903,102	11,984,067.49

No purchases of Mergenthaler stock were made by American after April 22, 1963. On April 22, 1963, Mr. Gurdon W. Wattles personally owned 560 shares of Mergenthaler. At that time he was also in control of American by his ownership of approximately 34% of American voting stock.

In February, 1957 Mergenthaler began acquiring common stock of Auto-Lite with an initial purchase of 20,000 shares. By the end of that year, Mergenthaler owned 126,400 shares of Auto-Lite common stock. By the end of 1958, Mergenthaler owned 212,600 shares of Auto-Lite common stock. By the end of 1959, Mergenthaler owned 379,950 shares of Auto-Lite common stock. And by May 24, 1960, Mergenthaler owned 408,950 shares of Auto-Lite common stock. These purchases of Auto-Lite stock by Mergenthaler were all for cash in the open market, and were chiefly made over the New York Stock Exchange. At the end of 1960 and at a cost of over $16 million, Mergenthaler's 408,950 shares constituted approximately 27% of the outstanding stock of Auto-Lite. By August of 1961, Mergenthaler effectively controlled the Auto-Lite Board of Directors.

From May 24, 1960 until March of 1962, Mergenthaler made no purchases of Auto-Lite shares. However, by July of 1961, Auto-Lite had purchased back 476,619 shares of its own common stock from its shareholders. Thus, by August, 1961, Mergenthaler's 408,950 shares constituted approximately 34% of the outstanding Auto-Lite stock. In March, 1962, Mergenthaler acquired an additional 219,065 shares of Auto-Lite by means of a tender offer to Auto-Lite shareholders under which Mergenthaler common stock and debentures were exchanged for Auto-Lite stock. As a result of these March 1962 acquisitions, Mergenthaler achieved ownership of between 53 and 54% of outstanding Auto-Lite common stock. Mergenthaler acquired no further Auto-Lite shares after March, 1962.

(2) Pre-Merger History

From its inception until the time of the merger, The Electric Auto-Lite Company was engaged in the manufacture of automotive products, including batteries, spark plugs, and basic electrical parts. Auto-Lite sold these products to automobile and truck companies for use as original equipment in the manufacture of new vehicles. It also sold these products as replacement parts to automobile manufacturers and to independent distributors.

Until the death of Auto-Lite's president, Royce Martin, in 1954, Auto-Lite had been chiefly identified with Chrysler, its principal customer under a long-standing relationship. Auto-Lite supplied Chrysler with automotive products which were manufactured on a long-run, high-volume assembly line basis, with an assured margin of profit. Until 1957, Chrysler remained the heart of Auto-Lite's business—its sales to Chrysler in that year were $134 million or 51% of its total sales.

In 1957, Chrysler informed Auto-Lite that it intended to manufacture certain basic electrical parts, i.e., starters, generators, distributors and regulators, which Auto-Lite was then manufacturing for it. Chrysler

expressed no intention as to certain other parts, i.e., batteries and spark plugs, which Auto-Lite was also manufacturing. Immediately after this announcement, Auto-Lite attempted to sell at least some of its manufacturing facilities to Chrysler. Chrysler declined, but agreed that while it was preparing its own plant, Auto-Lite could continue to supply electrical parts to it. At the expiration of the agreement, Chrysler ceased purchasing these parts from Auto-Lite. By 1962, Auto-Lite's sales to Chrysler declined from their 1957 high of $134 million to $21.6 million.

The decision of Chrysler to manufacture its own electrical parts reflected a change which was taking place throughout the automotive industry: Ford and Chrysler were "integrating" their businesses by producing automotive parts which traditionally had been supplied by Auto-Lite and other companies. General Motors had already integrated the production of its principal automotive parts.

This process of integration had an adverse competitive effect on Auto-Lite's business, in both the "original equipment" and the "replacement" markets. When Auto-Lite lost original equipment business to a manufacturer such as Chrysler, it also lost follow-up or replacement business for these parts. Car manufacturers also began to compete with Auto-Lite by manufacturing and distributing replacement parts for makes of cars other than their own.

As part of the industry-wide integration process, Ford decided in 1961 to develop its own facilities for the manufacture and distribution of batteries and spark plugs. Ford had not been producing these parts, and the decision had a detrimental impact on Auto-Lite's spark plug business with Chrysler. Champion Spark Plug Company, the then largest spark plug manufacturer in the United States, had been the exclusive supplier of spark plugs to Ford. General Motors was manufacturing its own "A.C." brand spark plugs. With the impending loss of the Ford business, Champion made a drive to become (and actually did become) the supplier of spark plugs to Chrysler.

Having lost Chrysler's electrical parts business, and faced with the impending loss of Chrysler's spark plug business to Champion, Auto-Lite sold to Ford, in April of 1961, for $28 million, the "Auto-Lite" trade name, its entire distribution organization for "Auto-Lite" replacement parts and its Fostoria spark plug and Owosso battery plants. This sale divested Auto-Lite of a significant percent of its assets and its sources of net sales. As part of the agreement, Ford agreed to purchase from Auto-Lite until April, 1964 a substantial volume of electrical and wire products, batteries, and spark plugs. The volume of these purchases during that three year period was approximately $16 million per year.

In the Spring of 1963, Ford informed Auto-Lite that it would not renew its purchase agreement at the end of the three-year term. A portion of the wire, electrical parts and battery business was obtained on a bid-basis in 1964, but Ford stopped purchasing spark plugs from Auto-Lite after April, 1964.

The evidence shows that by early 1963, the following circumstances existed at Auto-Lite with respect to its business in the automotive industry:

(1) The Chrysler business had decreased from 51% of Auto-Lite's total sales in 1957 to 12% in 1962, a drop of $112 million in volume.

(2) After the sale in 1961 of its trade name to Ford, Auto-Lite commenced promoting the "Prestolite" trade name, which at the time of the sale to Ford had accounted for annual replacement sales of approximately $1-½ million. This increased to approximately $2-½ million by 1963.

(3) In addition to the loss of Chrysler's spark plug business in Champion, Auto-Lite lost the Chrysler battery business in 1961.

(4) As a result of Ford going into the bumper business, Auto-Lite discontinued manufacturing this product.

(5) American Motors had begun purchasing its starting motors from Ford rather than Auto-Lite.

(6) Studebaker Company, which had been a substantial customer of Auto-Lite, announced in December of 1962 that it would discontinue the production of automobiles by September, 1963.

(7) Auto-Lite's spark plug sales totaled approximately $21 million in 1959; these sales, including sales to Ford under the three-year contract, had dropped to approximately $5 million by 1962.

(8) Sales to Ford, with the benefit of the contract which was to expire in April, 1964, had increased in 1962 by $5 million over the previous year.

(9) Auto-Lite's return on sales for its automotive divisions for 1962 was only 2.5% (wire), 1.5% (electrical), 3.0% (castings) and 3.7% (battery).

(10) Auto-Lite sales and net profits in the first and second quarters of 1963 increased over those of the previous year, with the benefit of the best automotive year in history.

(11) Auto-Lite management forecasted that sales and earnings would be lower for the third and fourth quarters of 1963.

(12) Automotive original equipment business for the electrical products division of Prestolite had declined from $58 million in 1960 to $18 million in 1962.

As a partial response to the changing nature of its automotive business, Auto-Lite entered into both a program of reorientation and diversification. Auto-Lite had depended on the automotive industry which was historically cyclical in nature. Thus, in reacting to the loss of Chrysler's business, Auto-Lite attempted to restructure its electrical products division and develop a new customer base. It moved its manufacturing facilities for certain electrical products from Toledo to Bay City, Michigan and the facilities for ignition parts to a new plant in Decatur, Alabama. These moves

permitted Auto-Lite to begin producing its basic electrical parts on a "short-run" basis, rather than the high volume runs which had been utilized for Chrysler. Auto-Lite also attempted to develop industrial markets for users such as Caterpillar Tractor Company.

Following the sale of the Auto-Lite trade name to Ford in 1961, Auto-Lite concentrated major efforts on producing "private label" products for automotive merchandisers, containing the users' brand names, such as Goodyear and Atlas. It also began to promote its "Prestolite" brand name.

In addition to these and other efforts to reorient its automotive operations, Auto-Lite explored new business areas which are not connected with the automotive industry. By 1959, Auto-Lite had made its first acquisition in the program of diversification. It purchased the C & D Battery Company, a manufacturer of industrial batteries. In 1960 Auto-Lite purchased the Marshalltown Manufacturing Company, a producer of industrial gauges and pressure instruments; the Equilease Corporation, a New York-based leasing company; and the Hiller Aircraft Company, a manufacturer of light helicopters for commercial and military use. Between its acquisition of Hiller in November 1960 and the merger in 1963, Auto-Lite made no other major acquisitions.

The plaintiffs contend that these facts, together with all else of record, demonstrate that there was an extensive program of diversification by Auto-Lite and a successful changeover in Auto-Lite's operations prior to the merger. They contend that Auto-Lite was not solely an automobile parts manufacturer either before or at the time of the merger. The record demonstrates, they contend, a bright financial outlook for Auto-Lite at the time of the merger.

The Mergenthaler Linotype Company, at the time of the merger, was a world leader in the production and distribution of linotype machines and parts and of other

typesetting equipment. It had developed a line of highly-engineered products and held a favorable position within the industry. Mergenthaler sold its products through a world-wide network of approximately 57 distributors, with offices in 111 countries and territories.

More than 50% of Mergenthaler's business was devoted to the sale of replacement parts and matrices. This substantial replacement market tended to protect it from adverse business cycles. Mergenthaler manufactured basically "proprietary" products which were of singular design and covered by patents.

Commencing in 1954, American Manufacturing Company, a manufacturer of cordage products, acquired an interest in Mergenthaler and representation on its board of directors. American's President, Gurdon W. Wattles, became chairman of the Mergenthaler board in 1956.

J. A. Keller, moved up from a consultant to Mergenthaler to become its vice president in 1955 and president in 1958. Under his direction, Mergenthaler's domestic manufacturing operations were modernized and expanded.

As early as 1958, Mergenthaler commenced production of the Linofilm photocomposition system, which combined photography and electronics in producing a made-up page of print on photographic paper, and in 1962 it entered into an agreement with CBS Laboratories for the development of ultra-high-speed composing and print-out devices utilizing cathode ray tubes, capable of being operated directly from computers and computer magnetic tapes. New technology and Mergenthaler's own research also permitted it to develop the most advanced phototypesetting equipment in the world. A $2,000,000 phototypesetting machine, developed by Mergenthaler, was contracted for by the U.S. Government Printing Office and the Air Force in the latter part of 1963. Mergenthaler's research and development activities have

been carried on at an expense of more than $2,000,000 per year. In 1962 and 1963 Mergenthaler sustained start-up costs in developing its Elektron, and certain non-reoccurring costs in its production of small office equipment. But these costs burdens were overcome in a short time. The evidence shows that the Mergenthaler business before the merger and subsequently as a part of Eltra was and continued to be a stable and substantial enterprise.

(3) Terms of the Merger

As of May 9, 1963, Mergenthaler had authorized the issuance of 4,000,000 shares of capital stock with a par value of $0.25 per share, of which 2,702,465 were issued and outstanding, 105,142 were held in Mergenthaler's treasury and 175,513 were reserved for issuance. As of the same date, Auto-Lite had authorized 3,000,000 common shares with a par value of $5.00 per share, of which 1,160,565 were issued and outstanding and 131,304 were held in Auto-Lite's treasury. According to the merger agreement, the amount of the authorized capital stock of the Consolidated Corporation, i.e., the Eltra Corporation, was to total $37,820,000—consisting of 5,000,000 Common Shares of par value of $0.25 per share and 1,060,000 shares of Preferred Stock of par value of $34.50 per share. The rights and powers of the preferred shareholders in Eltra were quite different from those of the Eltra common shareholders, and the preferred shareholders of Eltra could convert their stock for Eltra common stock at any time prior to July 1, 1968.

On May 29, 1963, the proposed merger agreement was sent to all Auto-Lite shareholders. On that same day, Mergenthaler's shareholdings in Auto-Lite were approximately 54% of the total shares outstanding; the total number of outstanding Auto-Lite shares was 1,160,565, 3,965 of which were owned by various officers and directors of American, Mergenthaler and Auto-Lite.

This was the picture of the three corporations at the time of a merger which has been found to have been brought about in violation of the law, and for which plaintiffs must be given some relief.[1]

In fashioning a remedy, I must initially consider the now well known congressional purpose behind § 14(a). "The purpose * * * is to prevent management or others from obtaining authorization for corporate action by

[1] My finding that the proxy statement in question failed to meet the requirements of Rule 14(a) was affirmed by the Court of Appeals and was recognized by the Supreme Court. *Mills, supra*, 281 F.Supp. at 827; 403 F.2d at 435; 396 U.S. at 384. The important aspect of this finding was my opinion that the omissions from the proxy statement were "material" for Rule 14a-9. This opinion would have remained, and even now remains, unchanged regardless of which standard of materiality was, or is, employed. *Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1301-1302 (2nd Cir. 1973); *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579, 604 (5th Cir. 1974); *Sonesta Int'l Hotels Corp. v. Wellington Associates*, 483 F.2d 247, 251, n. 3 (2nd Cir. 1973). Note, "The Reliance Requirement in Private Actions under SEC Rule 10b-5," 88 *Harv. L. Rev.* 584, 602, n. 84 (1975).

My finding that there was a causal connection between the omissions from the proxy statement and the merger was also affirmed by the Supreme Court. This finding also remains unchanged. Even if change were possible at this date there would be no basis for it, since there has been no rebuttal of the so-called "*Mills* presumption of causation." Note, "Causation and Liability in Private Actions for Proxy Violations," 80 *Yale L.J.* 107, 135-138 (1970) and *Chris-Craft Industries, Inc. v. Piper Aircraft Corp.*, 480 F.2d 341, 375 (2nd Cir. 1973). Such a change does appear to be precluded by the explicit language in the Supreme Court's decision, to wit:

> "Where there has been a finding of materiality, a shareholder has made a sufficient showing of causal relationship between the violation and the injury for which he seeks redress if, as here, he proves that the proxy solicitation itself, rather than the particular defect in the solicitation materials, was an essential link in the accomplishment of the transaction." *Mills, supra*, 396 U.S. at 385.
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> ". . . the Court of Appeals should have affirmed the partial summary judgment on the issue of liability." *Mills, supra*, 396 U.S. at 389.

See also *Chris-Craft, supra*, at 399-400.

means of deceptive or inadequate disclosure in proxy solicitation." Congress believed that fair corporate suffrage was an important right that should attach to all securities traded on a public exchange. *Borak, supra,* 377 U.S. at 431, citing H. R. Rep. No. 1383, 73d Cong., 2nd Sess., 13. In enacting § 14(a), Congress clearly intended to control the conditions under which proxies could be solicited so that certain abuses which had frustrated the free exercise of stockholders' voting rights in the past would be eliminated or at least reduced. The purpose is principally a public purpose, and incidentally and by necessity a private one. The principle beneficiary of the remedy is the public, and the remedy which the courts must fashion for the private person must be the one which, considering all the circumstances, best serves the public good. Accordingly, although the court's remedial powers in violations of § 14(a) are quite broad, limits on such powers do exist and have been recognized. For example, only actual damages or damages which can be shown may be recoverable. 15 U.S.C. § 78bb(a); *Mills, supra,* 396 U.S. at 389. These limits have been loosely read, however, so that relief may be available for a § 14(a) violation even if there is no link established between the misleading proxy solicitation and the outcome of the subsequent vote or even if the possible victims of the misleading proxy solicitation did not actually rely on that solicitation. *Mills, supra,* 396 U.S. at 385, n. 7; *Swanson v. American Consumer Industries, Inc.,* 475 F.2d 516, 523-524 (7th Cir. 1973) (J. Sprecher concurring); *Herbst v. International Telephone and Telegraph Corp.,* 495 F.2d 1308, 1316 (2nd Cir. 1974).

In this case plaintiffs have, ever since filing the complaint, asked for rescission of the merger, and even now continue to ask for it. Setting aside the merger should be granted only when from all the circumstances, including a consideration of hardships that may attend upon the defendants and their shareholders, as well as the length of time that has elapsed, it would be necessary as a public deterent as well as equitably necessary to the plaintiffs to break up the new entity

and return its parts to their original identities. *Mills, supra,* 396 U.S. at 388. Plaintiffs still contend, even after trial, that equity favors rescission. I ruled that such a rescission is inappropriate in this case in orders dated September 28, 1967 and January 10, 1972. (See: CCH Fed. Sec. L. Rep. ¶ 93,354 (N.D. Ill. 1972)). As was further stated in *Mills, supra,* 403 F.2d at 436, " . . . We do not consider that the policy of the '34 Act requires the court to unscramble a corporate transaction merely because a violation occurred . . ."

After carefully reconsidering the issue of rescission in light of all the evidence adduced at trial, I still am of the opinion that the merger should not be set aside. Contrary to the plaintiffs' latest assertions, this opinion does not give the defendants or others "a naked power of eminent domain." It recognizes, among other things: (1) the professed deterrent effects of the liberal damage theory which has developed under § 28(a) of the 1934 Securities Exchange Act; (2) the effect of the necessary delay in reaching the question of relief in this case due to the difficult questions of law and fact with which the parties and the Courts were presented (though without such delay rescission may have presented a less repulsive aspect, *Mills,* 403 F.2d at 435; (3) the best interests of all the former minority shareholders of Auto-Lite as a whole, *Mills, supra,* 396 U.S. at 388; (4) the traditional inability of judicially managed restoration to effectively restore without causing residual injury to innocent third parties; and (5) the ability of the Court to fashion an "equitable result" for the plaintiffs without unduly "punishing" the defendants, *Occidental Life Ins. Co. of N. Carolina v. Pat Ryan & Associates, Inc.,* 496 F.2d 1255, 1267 (4th Cir. 1974), U.S. Appl. Pndg., No. 74-329 and *Baumel v. Rosen,* 412 F.2d 571, 576 (4th Cir. 1969).

* * * * * *

What remains, therefore, and to what the masses of evidence of the trial were directed is what theory of measuring damages is best suited in this case for determining an equitable monetary award to the former Auto-Lite shareholders. Should it be based upon compensating for ". . . a reduction of the earnings or earnings potential . . ." of their holdings in Auto-Lite as a result of the merger, (*Mills, supra*, 396 U.S. at 389); or should it be based upon general equitable values " . . . predicated on a determination of the fairness of the terms of the merger at the time it was approved" (*Id.*)?

Since evidence had to be presented by either or both of the parties directed toward both theories, it was impossible to rule on certain objections to evidence interposed throughout the trial, without letting all evidence in subject to the objections. My decision here will serve to sustain objections to evidence given in support of the theory I ultimately reject. (See: *Gerstle, supra*, 478 F.2d at 1304-1307; *Janigan v. Taylor*, 344 F.2d 781, 786-787 (1st Cir. 1975), *cert. den.* 382 U.S. 879 (1965); *Affiliated Ute Citizens v. U. S.*, 406 U.S. 128, 155 (1972); *Rochez Bros., Inc. v. Rhoades*, 353 F.Supp. 795, 804 (W.D. Pa. 1973), *vac. and rem.* 491 F.2d 402, 417 (3rd Cir. 1974)).

While reviewing the testimony on the matter of monetary relief, an accounting of prior case law on the subject is in order.

The Fairness Theory

Since the Supreme Court's decision in this case, numerous courts have remedied violations of various provisions of the 1934 Securities Exchange Act by looking to the fairness of the terms of the transactions which were tainted by such violations. For violations of § 10b and Rule 10b-5, see *Affiliated Ute Citizens, supra*, 406 U.S. at 155; *Rochez Bros., supra*, 353 F.Supp. at 804-807 and 491 F.2d at 411-413; *Norte & Company v. Huffines*, 304 F.Supp. 1096, 1108-1111 (S.D. N.Y. 1968);

Dasho v. Susquehanna Corp., 461 F.2d 11, 27 (7th Cir. 1972), *cert. den.* 92 S.Ct. 2496, 2498. For violations of § 14, see *Norte, supra*, 304 F.Supp. at 1108-1111; *Dasho, supra*, 461 F.2d at 31. A transaction involving the purchase or sale of a security is generally deemed to be unfair when the fair value of what is received by the defrauded party exceeds the fair value of what would have been received in absence of violation(s). *Affiliated Ute Citizens, supra*, 406 U.S. at 155. Thus, where a merger is tainted with a federal securities laws violation, that merger will definitely be unfair if the exchange ratio employed either undervalued the stock shares yielded by the defrauded party and/or overvalued the stock shares yielded by the defrauding party, *Dasho, supra*, 461 F.2d at 27, *Wolf v. Frank*, 477 F.2d 467, 472 and 476 (5th Cir. 1973) and *Norte, supra*, 304 F.Supp. at 1108, and where such deflated and/or inflated values would not have arisen in the absence of fraud.

Primarily because there is no causation problem in this case since the Auto-Lite minority shareholders' votes were crucial to the merger, I find that the net proceeds which the Auto-Lite minority would have received in the stock exchange in the absence of a violation would have to have been based upon at least fair and accurate valuations of Auto-Lite and Mergenthaler stock at the time of the merger. Yet see *Brudney and Chirelstein*, "Fair Shares in Corporate Mergers and Takeovers," 88 *Harv. L. Rev.* 297, 313 and 322 (1974). There is no evidence that a more favorable exchange ratio would not have been available from Mergenthaler had there been full disclosure; and there is no reason to believe that the Auto-Lite minority would not at least have demanded an exchange ratio based upon accurate stock valuations at the time of the merger. *Dasho, supra*, 461 F.2d at 31; *Swanson, supra*, 475 F.2d at 519. Such a finding obviates the need of confronting a rather difficult legal problem involving the appropriateness of a damage award where a misleading proxy statement is issued by persons with more control over the actual stockholders' vote than that which existed here. *Mills,*

supra, 396 U.S. at 385, n. 7; *Dasho, supra*, 461 F.2d at 31; *Swanson, supra*, 475 F.2d at 521 (J. Cummings on damages) and at 529 (J. Sprecher on damages).

In attempting accurately to determine the fair value of the Auto-Lite and Mergenthaler stock at the time of the merger, I have had the benefit of a wealth of documentary evidence and the advice of a score of expert and non-expert witnesses. From these sources, I must recreate the setting at the time of the merger. I also have had the benefit of evidence on Eltra's market valuation shortly after the merger. *Brudney and Chirelstein, supra*, at 313-325.

While the parties differed as to the reasonable inferences and the factual basis of some of the documentary evidence, both sides agree that this Court must consider the following quantitative factors in assessing the terms of the merger: (1) market value; (2) earnings; (3) book value; and (4) dividends. These factors have long been considered relevant by courts faced with the task of gauging the value of a business. See, e.g., *de Haas v. Empire Petroleum Co.*, 300 F.Supp. 834, 837-838 (D.Col. 1969), *aff'd in part and rev'd in part*, 435 F.2d 1223 (10th Cir. 1971); *Lebold v. Inland S. S. Co.*, 82 F.2d 351, 356 (7th Cir. 1936) and 125 F.2d 369, 374-375 (7th Cir. 1942) *cert. den.* 316 U.S. 675 (1942); *MacCrone v. American Capital Corp.*, 51 F.Supp. 462, 466-469 (D.Del. 1943); *Hottenstein v. York Ice Machinery Corp.*, 136 F.2d 944, 952 (3rd Cir. 1953); *Bailey v. Tubize*, 56 F.Supp. 418, 423-425 (D.Del. 1944). And in considering these factors, it has been customary to review at least a five-year period for the purposes of comparison. It should be noted that the comparison in this case is not quite exact since Auto-Lite's yearly reports covered calendar years while Mergenthaler's annual reports covered fiscal years (ending September 30th).

Besides these quantitative factors, both sides agree that certain qualitative factors also must be considered in assessing the merger terms' fairness. Professor Nemmers testified that such factors include the industries and life-cycle stages of the companies involved; the

management quality or capacity of each company; the synergism which may arise from the merger; and the financial leverage of each company. Within or besides these factors, the merger terms in this case must be considered in light of the future prospects or "earnings potential" of each company as they may have been reliably projected at the time of the merger. This appears to be a particularly important consideration because of the changing nature of Auto-Lite around the time of the merger. Also see *Bailey, supra*, 56 F.Supp. at 424-425.

The Earnings or Earnings Potential Theory

Not all courts have looked to "fairness" as a basis for remedying Exchange Act violations; some have looked at the post-fraud activities of the violators in their search for an award of just relief. The Supreme Court in *Mills* directly recognized the propriety of this basis, 396 U.S. at 389, after having implicitly recognized it six years earlier, *Borak*, 377 U.S. at 433-435. And since the *Mills* decision, the Supreme Court has reaffirmed this recognition, *Affiliated Ute*, 406 U.S. at 155, wherein *Janigan* is cited with approval. Most courts granting relief based upon the post-transaction activities of securities laws violators have not distinguished between injured securities sellers and injured securities buyers. See *Janigan*, 344 F.2d at 786 and *Herzfeld v. Laventhol, et al.*, 378 F.Supp. 112, 129 n. 30 (S.D. N.Y. 1974). Yet also see *Zeller v. Bogue Electric Mfg. Corp.*, 476 F.2d 795, 801-802 (2nd Cir. 1973), *cert. den.* 414 U.S. 908, *Occidental*, 496 F.2d at 1264-1265; *Ohio Drill & Tool Co. v. Johnson*, 498 F.2d 186, 191 (6th Cir. 1974); and *Gerstle*, 478 F.2d at 1305. Such a distinction, if valid, would not appear to apply to the case at bar since the minority Auto-Lite shareholders were sellers as well as buyers in the merger transaction. *Dasho*, 461 F.2d at 18 and 27; *S.E.C. v. National Securities, Inc.*, 393 U.S. 453, 467-468 (1969).

Defendants have argued that the admission of nearly all post-merger evidence was improper. As noted earlier, historically when courts have relied upon the fairness of merger terms, the earnings potential of each company viewed as of the time of the merger has been considered. Thus, the phrase "earnings or earnings potential" in *Mills* must refer to something other than the loss of any earnings potential that existed at the time of the merger. This phrase has been interpreted to refer to the foreseeable and unforeseeable or windfall profits accruing to the injuring party as a direct result of the securities law violation. *Rochez Bros.*, 491 F.2d at 412; *Gerstle*, 478 F.2d at 1304 and 1306; *Gould v. American Hawaiian Steamship Co.*, 362 F.Supp. 771, 776-778 (D.Del. 1973); *Zeller*, 476 F.2d at 803. And this interpretation does not conflict with any later Supreme Court's statements on damages; for example, in *Affiliated Ute*, the Supreme Court stated that recovery under § 28 of the 1934 Act could be based upon the profit received by the injuring party wherein such profit exceeded the loss measured according to the fairness of the transaction at the time it was made. It thus appears that some plaintiffs may recover for the loss of their potential for earnings which may be determined to have existed at the time of a tainted securities transaction—even though such potential never materialized. It further appears that where the earnings potential at the time of the tainted transaction later materialized, some plaintiffs may recover the greater value between the fair worth of the earnings potential at the time of the transaction and the actual profit received by the injuring party as a direct result of the transaction—even though the potential for such profit was totally unforeseeable at the time of the merger. This variety in approach to the basis of recovery under § 28 can be and has been justified, in part, by pointing out the need for effective private enforcement of the federal securities laws. *Borak*, 377 U.S at 433-435; *Mills*, 396 U.S. at 386.

At first glance, it might seem as though many cases have rejected this interpretation of the phrase "earnings or earnings potential" and have thereby rejected it as a basis of relief. However, upon closer examination, it appears that most of these cases have not so rejected this interpretation but simply have not faced it. *Dasho*, 461 F.2d at 25, n. 33 and 27-28; *Wolf*, 477 F.2d at 478; *Swanson*, 475 F.2d at 519-521. Relief based upon post-transaction events rather than upon events existing at the time of the transaction is seldom requested and is infrequently granted when requested, in part, because: (1) proof of post-merger events is often more unavailable to plaintiffs than is proof relating to events preceding the securities violation(s); (2)[2] "commingling of the assets and operations" involved in a securities transaction often "makes it impossible" to later establish the direct injury as measured by post-transaction events; and (3) often, it is hard to determine the degree to which the injuring party's own efforts caused certain post-transaction events or, otherwise stated, the degree to which post-transaction events occurred independent of the injuring party's actions. Thus, relief based upon post-transaction events may be granted, when proven, even if the securities transaction was itself fair at the time of consummation. *Affiliated Ute*, 406 U.S. at 155; *Mills*, 396 U.S. at 389; *Rochez Bros.*, 491 F.2d at 411 and 416-417.

* * * * * *

In considering the fairness of the merger terms, the quantitative factors of market value, earnings, book value and dividends should be examined as of the time of the merger, as should certain qualitative factors. In considering the loss to the plaintiffs of earnings or earnings potential and thus whether relief can be based on the post-merger activities of Eltra, the post-merger position of the former Auto-Lite shareholders should be compared with the post-merger position of the former Mergenthaler shareholders. Consider first the factors

[2] See *Mills*, 396 U.S. at 389. On (3), see *Janigan*, 344 F.2d at 787; *Rochez Bros., supra*, 353 F.Supp. at 804-804 and 491 F.2d at 412 and 417; and *Gerstle*, 478 F.2d at 1306.

important to measuring the fairness of the merger terms, then the factors important to measuring injury due to loss of earnings or earnings potential.

Fairness of Merger Terms in This Case

Market Value.

Plaintiffs, in part, contend that the ratios of the prices of Mergenthaler and Auto-Lite stock prior to the merger cannot support the ratio of 1.88 to 1 established by the merger, and rest their contention chiefly on the testimony of Dr. Nemmers. Nemmers stated that the prices of Auto-Lite and Mergenthaler stock for the years 1961, 1962 and 1963 were not achieved in a free and reliable market; he found the market to be an unreliable indicator of value in those years because of the various transactions by Auto-Lite, Mergenthaler, American and Gurdon Wattles involving Auto-Lite and Mergenthaler stock. While apparently agreeing that the market price of a stock can reliably indicate only the value of the stock when the stock is freely and actively traded, defendants contend that the market values for 1961-1963 are more reliable than those for 1958-1960.

While I am of the opinion that the so-called "intercompany" transactions between 1961 and 1963 caused the stock prices in those years to be unreliable indicators, I also consider the prices for 1958-1960 unreliable. Between 1958 and 1960, there occurred numerous and similar intercompany transactions. But regardless of the reliability of these prices, the nature of the Auto-Lite business at the time of the merger in 1963 was quite different from its nature prior to 1960. For this reason, it would not be responsible to consider the pre-1960 prices of Auto-Lite stock in calculating an exchange ratio for the merger. Further, the evidence shows only minor trading by American in Mergenthaler stock after the early part of 1962, and none by Mergenthaler in Auto-Lite stock after the early part of 1962. There is no competent evidence of any major attempt by or opportunity for either American or Mergenthaler to influence

the prices at or near the time of the merger, and the 2.1 to 1 ratio for 1962 and early 1963 may thus indicate relative market appraisal. Finally, the record does indicate that the market prices of both Auto-Lite and Mergenthaler increased generally and performed better than the average stock prices during the time when the final merger proposal was being drawn up and circulated. It is impossible to delineate from the evidence the reasons for this. From the foregoing, it seems to me that a comparison of the market value of the stock of the two companies at the time of the merger cannot play an important role in determining the fairness of the merger plan.

Earnings

In determining Mergenthaler's net income for 1962, I have considered Mergenthaler's deferred credit of $789,000. The deferred credit reflected part of Mergenthaler's excess equity in Auto-Lite after it had gained over 50% control of Auto-Lite. The parties disagree about the propriety of recognizing deferred credit, at least when assessing the amount of income to be used in determining merger terms. However, the weight of the evidence makes considering deferred credit necessary. Even were the deferred credit not considered in computing the earnings per share of Mergenthaler for 1962 and early 1963, the difference in the resulting ratios of Auto-Lite to Mergenthaler would be minor.

After weighing all the evidence with respect to the pre-merger earnings of Auto-Lite and Mergenthaler, two important observations can be made. First, the earnings ratio as of the merger date parallels the merger's actual exchange ratio (later discussed). Second, the trend in the various earnings ratios calculated for some periods immediately prior to the merger favors Auto-Lite. Such a trend may reflect both that Auto-Lite experienced some success in its program of reorienting and diversifying its operations and that Mergenthaler had experienced a downward turn in the profitability of its traditional operations.

It appears to me that to the extent to which the earnings picture of Auto-Lite and Mergenthaler can be measured on a common scale, earnings are an important factor in determining fairness of the merger terms, and that the actual earnings ratio between the two companies was at the time of the merger more favorable to Auto-Lite than the merger plan would have to have taken into account.

Book Value.

While both parties agree that it is customary to examine book value when determining fairness of merger terms, the defendants contend that book value considerations would be an insignificant factor in this merger. It is often true that a company's book value is simply an indication of the historical cost of its assets and that it bears relation neither to the value of the company's assets nor to the ability of the company's assets to earn. Dr. Nemmers properly suggests that book values can be quite deceiving. The possibility of some of this deception exists in this case since there has been no basis for a reliable comparison between the physical assets and liabilities of Auto-Lite and those of Mergenthaler. Nothing in evidence effectively assists us in determining which company's assets and liabilities were stated accurately or were more overstated or less understated, and by how much.

While recognizing this possibility of "deceit," Dr. Nemmers placed great weight on book value in assessing the terms of the Eltra merger. The evidence shows that Auto-Lite's book value on March 31, 1963 was $88.01 a share while Mergenthaler's was $32.16 on March 17, 1963. Based upon these values, it would require about 2.74 shares of Mergenthaler to equal in book value one share of Auto-Lite in March, 1963. This ratio is not in dispute, although its relevance to the question of fairness is. Dr. Nemmer's higher ratio of 3.4 to 1 is questionable in light of my concern for deferred credit. While arguing book value is an insignificant factor in this case, defendants concede the importance of

considering book value compared with other economic data. For example, they examined book value in its relation to the market value and earnings of Auto-Lite and Mergenthaler at the time of the merger.

Given the nature of Auto-Lite's substantial liquid asset position at the time of the merger, I am of the opinion that book value should play a significant role in assessing the fairness of the Eltra merger.

Dividends.

Plaintiffs, relying chiefly on the testimony of Dr. Nemmers, contend that the evidence as to the pre-merger dividend policies of Auto-Lite and Mergenthaler show that the terms of the merger were unfair and that an exchange ratio of 3 to 1 would have been reasonable. This contention is weak since it was made without reference to or analysis of other factors such as market value and earnings per share. For example, if a share of Auto-Lite sold throughout 1962 for $24 and if a share of Mergenthaler sold throughout 1962 for only $4, then an investor of $24 in Mergenthaler at the beginning of 1962 would have received $6 in dividends at the end of 1962 while an investor of $24 in Auto-Lite at the start of 1962 would have received only $2.40 in dividends at the end of the year. In the example, the Mergenthaler investor would have received over twice as much in dividends as the Auto-Lite investor even though the money investment would have been the same and the actual dividend ratio would have been in favor of Auto-Lite.

The evidence shows that in 1962 the price of a share of Auto-Lite stock averaged $55 while the price of a share of Mergenthaler stock averaged $25.80. Thus in most of 1962, one could have owned two shares of Mergenthaler for every share of Auto-Lite yet one would have received $2.00 in dividends from Mergenthaler compared with $2.40 in dividends from Auto-Lite. In most of 1958 and 1959 one could have owned three shares of Mergenthaler for every share of Auto-Lite. One possessing three shares

of Mergenthaler in 1959 would have received $1.50 in dividends compared with Auto-Lite's dividend of $2.50 per share.

Plaintiffs argue that the ultimate return to a stockholder has to be either in the form of dividends or capital gains; that the price of stock is heavily dependent upon its dividend; that while under Mergenthaler's control Auto-Lite paid out in dividends about 86% of its earnings; and that this depressed the price of Auto-Lite stock while raising that of Mergenthaler. Whatever the effect the ratio of dividends to net earnings may have on the price of stock, the evidence on dividends and earnings per share, when read together, shows that Auto-Lite itself paid out high dividends in relation to its earnings prior to Mergenthaler's assumption of control. Auto-Lite's earnings per share in 1958 were $1.78 while its dividend per share was $1.40—the pay out rate in 1958 was thus about 79%. Auto-Lite's pay out rate in 1959 was 56%, in 1960 it was 71%, and in 1961 it was 114%. During several years prior to 1958 Auto-Lite's pay out rate was similarly quite high. The evidence shows that Mergenthaler acquired legal control over Auto-Lite about midway through the 1962 fiscal year and that Auto-Lite's 1962 pay out rate was 87% and its pay out rate for the first half of the 1963 fiscal year was 53%.

Prior to the merger, the dividend per share of Auto-Lite stock had been $2.40. Under the terms of the merger, former Auto-Lite shareholders were assured for at least some time of receiving as earnings on Eltra common stock ownership $2.63 equivalent of each share of former Auto-Lite stock. This $2.63 was cumulative and was senior to the payment of any dividend on the new Eltra common stock.

It seems to me that the weight of the evidence with regard to the factor of dividends does not show an unfair undervaluation of Auto-Lite stock at the time of the merger.

Qualitative Factors.

Plaintiffs' expert witness, Professor Nemmers was of the opinion that a reliable determination of a fair exchange ratio could be based upon quantitative factors which would not have to be adjusted to reflect qualitative factors. Some bases important to this opinion are supported by the evidence and are uncontroverted by the defendants. Other bases run contrary to the evidence. For example, he testified that "there was no synergism present." Defending this position he stated that Mergenthaler's claim that it "could do something overseas with Auto-Lite" carried "no value" since Mergenthaler functioned in the industrial market while Auto-Lite had "quite a different sales operation" serving the consumer market. But the evidence is that Auto-Lite at the time of the merger had been moving sales in the industrial market, particularly with respect to its development and promotion of industrial batteries. Professor Nemmers then testified that although Auto-Lite was in the automotive industry and Mergenthaler was in the printing machinery industry and though these industries were both susceptible to variations, they were not significantly different from each other. Yet the evidence is that Auto-Lite was a part of the automotive industry which characteristically is cyclical, and Auto-Lite's sales and profits up to the time of the merger reflected this characteristic. At the same time the printing machinery industry was not similarly cyclical and Mergenthaler's profits and sales were far more stable.

Again, Professor Nemmers taught that both Auto-Lite and Mergenthaler were mature companies at the time of the merger and that no adjustment was necessary with respect to the qualitative factor of the "life cycle stage." But the evidence easily shows that at the time of the merger Auto-Lite was at a life cycle crossroad and faced serious market risks with respect to some of its products, while Mergenthaler faced no such risks.

Considering further these qualitative factors, in its statement of income for the fiscal year 1962, Mergenthaler showed a net income of $5,522,000. Of this total $789,000 was for amortization of deferred credit. This amount was due solely to the acquisition of control in Auto-Lite. Without the deferred credit, Mergenthaler's 1962 income of $4,733,000 compares somewhat unfavorably with its earnings of $4,898.000 in 1961. Mergenthaler's stated 1961 income included credit for only the dividends received from Auto-Lite while the Mergenthaler 1962 adjusted income figure of $4,733,000 apparently included credit not only for dividends, but also for at least some of the excess of Auto-Lite's profits over its dividends in 1962. Auto-Lite earned $2,847,000 in 1961 and $3,243,000 in 1962.

As noted earlier, between 1957 and early 1963 the Electric Auto-Lite Company was involved in several major transactions which would have had a significant effect on its future had there been no merger. Although Auto-Lite was at a crossroads and faced certain risks as a result of these transactions, the evidence indicates that its earnings prospect or potential was quite good when viewed at the time of the merger. Recognizing the changing character of the automotive business, it had undertaken several programs of reorientation and diversification—beginning as early as 1959. By early 1963, it had reversed an earlier decline in sales and profits which occurred between 1960 and 1961. At that time the outlook for the remainder of 1963 was good. By early 1963, Auto-Lite's program of diversification had shown signs of success. C & D Batteries' income had substantially risen since its acquisition in 1959, despite a setback in 1961; C & D was quite successful and had an excellent outlook at the time of the merger. Equilease Corporation, acquired by Auto-Lite in 1960 and 1961, was also successful at the time of the merger. Eltra noted shortly after the merger an anticipated "substantial volume of automobile leasing business." Marshalltown Manufacturing Company, acquired in 1960, was according to the defendants' own witness, "satisfactorily

profitable" at the time of the merger and "gaining ground and in pretty solid shape." On the other hand, Hiller Aircraft Corporation, acquired by Auto-Lite in 1960, proved to be an unsuccessful investment which Auto-Lite sought to dispose of prior to the merger and remained a blotch on Auto-Lite's future at the time of the merger.

* * * * * *

In trying to measure damages by "earnings or earnings potential," special difficulties are encountered. The idea is to establish what happened to the merged corporation by exposing what happened to its assets when reemployed or liquidated by the successor corporation. The approach may include elements of substantial scienter in the merger plan and entails problems in tracing assets and in determining the period of post-merger time to be exposed to investigation.

Professor Sorter was the plaintiffs' primary witness on the post-merger activities of Eltra. Sorter made a study of certain Eltra and Auto-Lite corporate records to determine whether or not it was possible to trace the post-merger operations of the various Auto-Lite components or divisions which had independently existed just prior to the merger. Having determined that such tracing was possible, Sorter then made a study to ascertain the nature of the direct injury, if any, to the former Auto-Lite minority shareholders as a result of the merger. He concluded that there had been direct injury in excess of $69 million as of October 1, 1972.

Professor Sorter's conclusion was based upon the difference between what he determined to be the earnings actually received by the EAL minority since the date of the merger, and what he determined to be the "in fact" earnings of the various former Auto-Lite components. He used as his base measure a calculation of the value of the EAL minority's stock had there been no merger. His basic assumption was that had there been no merger the distribution of assets from the Auto-Lite divisions to other divisions of Eltra could have been

made only in the form of dividends. For several reasons, I am of the opinion that Professor Sorter's examination of the post-merger activities of the Eltra Corporation cannot serve as a basis for granting relief in this case.

One reason is that Professor Sorter was able to trace the movements of only a limited number of the assets of the former Auto-Lite divisions. He worked with only those assets which were expressly reported in the consolidated balance sheets and the consolidated income statements of Eltra's annual reports and in Eltra's Consolidating Balance Sheet and Consolidating Statements of Net Income. Defining the term "assets" as including all items of value held by the former Auto-Lite divisions at the time of the merger, it is clear to me that Sorter could not trace the flow of all former Auto-Lite assets because items such as the quality of management and the benefits of synergy were not expressly found in Eltra's annual reports and statements. When questioned about the possible influx of managerial talent from the former Mergenthaler divisions into the former Auto-Lite divisions he replied that such an influx could not be ". . . attributed strictly to the merger, because Mergenthaler was in control prior to the merger as they were in control after the merger." He presumed without facts to support it, that there was no difference between the manner of organizing and managing Mergenthaler personnel and Auto-Lite personnel prior to the merger and the manner of organizing and managing Eltra personnel after the merger. The fact is, as Professor Vancil stated, that beneficial transfers of personnel between divisions of a new company occur because of the divisions' merger, and there is evidence that the manner of organizing and managing Auto-Lite division personnel actually changed after the merger. This is an important consideration. *Gerstle*, 478 F.2d at 1306. As to synergism resulting from the merger, Professor Sorter, was of the opinion that the merger did not affect economic synergism to any significant degree. Yet the evidence shows that

Mergenthaler's position of control over Auto-Lite prior to the merger was different from Eltra's after the merger. For example, numerous operating economies arose subsequent to the merger. In conclusion then, I am of the opinion that Professor Sorter's analysis excluded certain assets from his picture of the post-merger asset flow of the former Auto-Lite divisions. Professor Sorter's conclusion that there was a direct injury in excess of $69 million is of questionable vitality.

The Eltra consolidating statements relied on by Professor Sorter inadequately report the actual expenses incurred by the former Auto-Lite divisions and thus undervalue the infusion of assets in an independent way. As Mr. Carracio testified, it is customary for multi-divisional companies to incur certain expenses on behalf of some of its divisions, to charge these expenses to a central account in its consolidating statement, and to not allocate these expenses back to the various divisions benefiting from the expenses incurred. Such non-allocation is not improper when the consolidating statement is, as were those available to Professor Sorter, drawn up for internal purposes only and not for public consumption. At least two witnesses, Keller and Wattles, testified reliably that Eltra Central, a separate central service unit in Eltra's consolidating statement, was charged with certain expenses which benefited particular divisions, which expenses were not allocated back as part of the liabilities of the respective divisions.

Professor Sorter calculated the "distribution of EAL assets," i.e., the dollar value of the assets flowing out of the former Auto-Lite divisions in any one year, by subtracting the ending equity of all these divisions from the sum of their beginning equity and their income for the year. For each of the years between 1963 and 1972, he found there was such a distribution. His form of calculating damages rests on the assumption that had there been no merger the Auto-Lite minority shareholders rather than the non-former Auto-Lite components of Eltra would have received a share of this

"distribution" and that they would have reinvested these yearly receipts. This assumption is unrealistic and cannot reliably serve as a basis for computing injury.[3]

I find in this case not enough evidence of sufficient reliability to utilize the earnings and earnings potential

[3] In assuming that there would have been a yearly dividend equal to the amount of "distribution", Professor Sorter also assumed that the hypothetical Auto-Lite company would have made the same decision to distribute assets out of its divisions. Such an assumption is invalid since it is not known whether or not the former Auto-Lite divisions' assets were distributed by Eltra in any one year because Eltra thought those assets could no longer be profitably utilized in the former Auto-Lite divisions. It may well have been that in one year Eltra distributed the EAL divisions' assets because it thought that a former Mergenthaler division could earn with those assets at a 20% profit rate while any former Auto-Lite division could earn at no higher than a 15% profit rate; in such an instance, yet without the merger, the assets in question would probably have been utilized internally by the hypothetical Auto-Lite rather than distributed as dividends. In a situation where the decision by the hypothetical Auto-Lite would have been to distribute, Professor Sorter made a further assumption that the distribution which he had calculated could have actually been transformed into dividends. This further assumption is also invalid under certain circumstances. For example, the distribution for 1964 was found to be in excess of $26 million. Yet this distribution may have represented, in large part, a transfer of certain land from a former Auto-Lite division to a former Mergenthaler division, which land carried a book value in excess of $26 million. Without the merger, Auto-Lite presumedly would have had to sell the land, or lease it, in order to distribute dividends. If the land was actually worth only $5 million, or was unleasable, the result would have been a distribution of $5 million in dividends, at best.

Even without these deficiencies in the methodology and implementation of Professor Sorter's analysis, the figure of $69 million in damages is unrealistic since it was reached only after several substantially erroneous assumptions were made. For example, this damage figure rests upon the assumption that no former EAL minority shareholder has sold his Eltra stock since the merger, although it does account for the conversion of Eltra preferred into Eltra common. Yet it is undisputed that most of the former Auto-Lite shareholders at the time of the merger no longer own any type of Eltra stock.

concept as a basis for measuring damages. This does not mean that in the next case the evidence could not be substantial and convincing.

In light of all the foregoing, I conclude that in this case the monetary relief that must be made available to the plaintiffs must be based upon the theory of the unfairness of the terms of the merger. Before calculating the amount of damages, however, it is necessary to determine with finality who shall be the proper recipients of a monetary award.

* * * * * *

Plaintiffs Mills and Sussman brought this suit in alternative forms; they sued on behalf of themselves and a similarly-situated class of former Auto-Lite stockholders, and they sued derivatively on behalf of Auto-Lite. This Court long ago recognized that there may have been injuries to both Auto-Lite and to its stockholders resulting from the defendants' actions.

And similar suits involving allegations of improper proxy solicitation and other types of illegal representations have elsewhere been instituted, and have been allowed to proceed on both derivative and class claims. *Kahn v. Kaskel*, 367 F.Supp. 784 (S.D. N.Y. 1973); *Ruggerio v. American Bioculture, Inc.*, 56 F.R.D. 93, 96-97 (S.D. N.Y. 1972). To this date, I have refrained from determining which form would be employed in the granting of any relief—thinking it wise to make such a determination only after all the facts had been presented. *Johnson v. American General Ins. Co.*, 296 F.Supp. 802, 810 (D. D.C. 1969). Several preliminary findings on these two forms of action have, however, been made.

On May 22, 1972, I determined that this action could be maintained as a class action and that the class included ". . . those persons who were Auto-Lite shareholders at the time of the merger and who have continuously retained their stock interests since the merger." Rule 23(c)(1) of the Federal Rules of Civil

Procedure (hereafter F.R.C.P.). The validity of this definition formed a partial basis for certain plaintiffs' motions for reconsideration.

The finding that a cause is maintainable as a class action and all other orders issued pursuant to such a finding are interlocutory in nature and may be altered or amended before a final judgment. Rule 23(c)(1) and 23(d) of F.R.C.P.; *Walsh v. City of Detroit*, 412 F.2d 226, 227 (6th Cir. 1969); *Fischer v. Kletz*, 41 F.R.D. 377, 386 (S.D. N.Y. 1966); *Brennan v. Midwestern United Life Ins. Co.*, 259 F.Supp. 673, 683 (N.D. Ind. 1966). The Seventh Circuit Court of Appeals implicitly recognized the interlocutory nature of this Court's class action rulings by denying plaintiffs' petition for a writ of mandamus on February 15, 1973. This Court has also consistently recognized the unfinality of its class action rulings by allowing the submission of certain motions for reconsideration since May 22, 1972.

In defining the class, I held that persons who purchased Eltra shares subsequent to the merger and were not Auto-Lite shareholders at the merger date acquired no cause of action by such stock purchase. After reconsideration, I am still of the opinion that such purchasers have no right to share in any recovery in this case. *Schwartzman v. Tenneco Mfg. Co.*, 319 F.Supp. 1278, 1283 (D.Del. 1970); *Independent Investor Protective League v. Saunders*, 64 F.R.D. 564, 572 (E.D. Pa. 1974).

In defining the class, I also held that Auto-Lite's shareholders at the merger date who have since sold their shares in Eltra have voluntarily removed themselves from the class and have no right to share in a possible recovery. I relied, in large part, on the case of *Speed v. Transamerica Corp.*, 99 F.Supp. 808, 135 F.Supp. 176 (D.Del. 1955), *modified and affirmed on appeal*, 235 F.2d 369 (3rd Cir. 1956) in so holding. Upon reconsideration, I am now of the opinion that the sale of Eltra preferred or common stock by the former Auto-Lite minority shareholders (hereafter "sellers") should

not, in itself, preclude any recovery by them. *Sirota v. Econo-Car International, Inc.*, 61 F.R.D. 604, 607 (S.D. N.Y. 1974); *Swanson v. American Consumer Industries, Inc.*, 415 F.2d 1326, 1333 (7th Cir. 1969); *Herbst v. Able*, 47 F.R.D. 11, 15 (S.D. N.Y. 1969); *Hilda Herbst v. I.T.T. Corp.*, 495 F.2d 1308, 1314 (2nd Cir. 1974); *Madonick v. Denison Mines Limited*, 63 F.R.D. 657, 658-659 (S.D. N.Y. 1974); *Hohmann v. Packard Instrument Co., Inc.*, 471 F.2d 815, 817 (7th Cir. 1973). I do note that at the time this particular holding was rendered, the plaintiffs appeared to me to be still vigorously pursuing their request for rescission—in spite of my rulings of January 10 and March 24, 1972; thus, plaintiffs' ability to adequately represent their alleged class was somewhat doubtful in May of 1972. See *Guttman v. Braemer*, 51 F.R.D. 537 (S.D. N.Y. 1970); *Weisfeld v. Spartans Industries, Inc.*, 58 F.R.D. 570, 582 (S.D. N.Y. 1972); *Ruggerio, supra*, 56 F.R.D. at 95; *Wood v. Rex Noreco Co.*, 61 F.R.D. 669, 674 (S.D. N.Y. 1973). It should be noted that this particular holding had no effect on the derivative claims which the plaintiffs were also prosecuting. My position today also is influenced by my determination that here the fairness of merger terms theory must be used in assessing a monetary award.

My recognizing today the availability of relief to all Auto-Lite shareholders as of the merger date—regardless of their present stock interests in either Auto-Lite or Eltra—does not mean, however, that there must be a monetary relief for all of them or that any monetary relief for those no longer holding Eltra stock must equal that awarded to the class of minority Auto-Lite shareholders initially defined on May 22, 1972. *Sirota, supra*, 61 F.R.D. at 607; *Swanson, supra*, 415 F.2d at 1333; *Herbst, supra*, 47 F.R.D. at 15; *Hilda Herbst, supra*, 495 F.2d at 1314; *Matarazzo v. Friendly Ice Cream Corp.*, 62 F.R.D. 65, 70 (E.D. N.Y. 1974).

Related to the issue of class membership are the objections to my requiring prospective plaintiffs to file proofs of claims, and my approval of certain forms of notice mailed to potential class members. In light of what is said below these objections need not be considered.

From the outset, this case has included both derivative and class action claims. All parties have recognized that both of these claims could, in sum, yield only "actual damages." It has been said that a derivative suit closely resembles a class action suit. *Ross v. Bernhard*, 396 U.S. 531, 535 n. 5 and 541 (1970); *Weiner v. Winters*, 50 F.R.D. 306, 309 (S.D. N.Y. 1970). I am of the opinion that, in this particular case, relief can be based upon either or both the derivative and the class action claims but that such relief would have to be singularly the same.

Count II could have been brought as a derivative cause. *Borak, supra*, 377 U.S. at 431. It appears that a derivative action is the preferred private method for vindicating violations of § 14(a), since the "injury which a stockholder suffers from corporate action pursuant to a proxy solicitation ordinarily flows from the damage done the corporation, rather than from the damage inflicted directly upon the stockholder." *Id.* at 432. See also *Borak, supra*, 317 F.2d at 845. Without the vehicle of the derivative action, private relief and thus private enforcement (the latter being a "necessary supplement" to S.E.C. action) under § 14(a) essentially would be denied. In their earlier decisions in this very case, both the Seventh Circuit Court of Appeals and the Supreme Court observed that this suit was being prosecuted, in part, as a derivative action, and the Supreme Court indicated several times in its opinion that the plaintiffs had rendered a substantial service to both Auto-Lite and its shareholders by instituting the action. *Mills, supra*, 403 F.2d at 431 and 396 U.S. at 378, 388, 392 and 395-396.[4]

[4] Recognizing a suit under § 14(a) to be derivative in nature rather than a class action is particularly justified when the relief sought is the rescission of corporate action, *Basch v. Talley Industries, Inc.*, 53 F.R.D. 9, 12 (S.D. N.Y. 1971), yet a request for equitable relief is not essential to such a recognition, *Dasho v. Susquehanna Corp.*, 461 F.2d 11, 15 (7th Cir. 1971). See also *Kauffman v. Dreyfus Fund, Inc.*, 434 F.2d 727 (3rd Cir. 1970) *cert. den.* 401 U.S. 974, *Wolf, supra*, and

(Footnote continued on following page)

A review of Rule 23.1 of the F.R.C.P., as well as former Rule 23(b) (which was in effect at the commencement of this lawsuit) convinces me that it would be proper in this case to fashion a single relief based upon both claims.

Although the individually named plaintiffs continuously have urged rescission to be the most appropriate form of relief, since my original finding on the matter of rescission, and particularly at trial, they also have directed their arguments and evidence toward the matter of monetary relief for Auto-Lite and its shareholders. They have represented adequately all Auto-Lite shareholders at the time of the merger, including those who still hold Auto-Lite stock as well as those who now hold shares of Eltra preferred stock as a result of the merger, those who now hold shares of Eltra common stock as a result of the merger, and those who no longer hold an interest in either Auto-Lite or Eltra, *Hilda Herbst, supra*, 495 F.2d at 1314; *Madonick, supra*, 63 F.R.D. at 658-659. The fact that they themselves still retain certificates of stock ownership in Auto-Lite does not preclude their prosecution of the derivative cause. *Smallwood, supra*, 489 F.2d at 591, n. 11.

Besides requiring the appearance of fair and adequate representation, the present rule on derivative actions also provides that the complaint shall allege ". . . with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority . . . and the reasons for his failure to obtain the action or for not making the effort." Rule 23.1

[4] *continued*
the Rule 10B-5 case of *Swanson v. American Consumer Industries, Inc.*, 288 F.Supp. 60 (S.D. Ill. 1968), *rev'd and remanded* 415 F.2d 1326 (7th Cir. 1969), 328 F.Supp. 797 (S.D. Ill. 1971), *rev'd and remanded* 475 F.2d 516 (7th Cir. 1973) (where the final appellate decision found damages for each shareholder of a dissolved corporation, i.e., on the derivative claim, 475 F.2d at 521 and 529, after the trial Court had earlier dismissed the class action claim, 288 F.Supp. at 61, which dismissal was not apparently reviewed).

of F.R.C.P. Effort to obtain action, however, may be excused where it would have been futile or simply an empty formality. Under the circumstances of this case, such an effort by the plaintiffs is properly excusable—since Mergenthaler owned 54% of Auto-Lite and controlled its Board of Directors, *de Haas v. Empire Petroleum Co.*, 286 F.Supp. 809, 813-815 (D.Col. 1969), *aff'd in this part, rev'd in other part*, 435 F.2d 1223, 1228 (10th Cir. 1971); *Wickes v. Belgian Am. Educational Foundation, Inc.*, 266 F.Supp. 38 (D.C. N.Y. 1967); *Weiss v. Sunasco, Inc.*, 316 F.Supp. 1197 (D.C. Pa. 1970); *Gottesman v. General Motors Corporation*, 268 F.2d 194 (2nd Cir. 1959); *Treves v. Servel, Inc.*, 244 F.Supp. 773 (S.D. N.Y. 1965); 48 A.L.R. 3d 595, § 10 at 637-69.[5]

I further am of the opinion that Ohio law does not foreclose the awarding of relief under the plaintiffs' derivative claims, even though Auto-Lite has ceased to exist during the pendency of this case. The awarding of relief under the derivative claims would be proper only if Auto-Lite had the power and capacity to bring this cause of action on its own behalf. There is no doubt that such power did exist. *Swanson, supra*, 415 F.2d at 1333-1334. The capacity of Auto-Lite to sue in this Court is governed by Ohio law. Rule 17(b) of F.R.C.P.; *Basch v. Talley Industries, Inc.*, 53 F.R.D. 9, 11-12 (W.D. Okl. 1971).

While the issue of a dissolved Ohio corporation's capacity to sue may not be necessary to the final disposition of this case, I have decided to face it because I believe some clear direction has previously been given by the U. S. Supreme Court in federal securities law cases and by Ohio statutory and case law. Cf. *Smallwood, supra*, 489 F.2d at 591, n. 12. In *Borak*, where the Supreme Court first held that derivative causes involving alleged violations of § 14(a) were permissible under the 1934 Securities Exchange Act, it was

[5] Unlike the situation in *Claman v. Robertson*, 164 Ohio Stat. 61, 128 N.E.2d 429 (Ohio Sup. Ct. 1955), here there was no effective ratification of the misleading proxy statement by the disinterested shareholders.

stated that certain remedies could be fashioned despite contrary provisions on the availability of such remedies under applicable State corporation laws. 377 U.S. at 434.[6]

Both prior to and after the *Borak* decision, other federal and state courts have allowed derivative claims, including some brought under the federal securities laws, to proceed notwithstanding the dissolution or abandonment of the nominal corporate defendant on whose behalf the claims were brought. *Miller v. Steinbach*, 268 F.Supp. 255, 266-269 (S.D. N.Y. 1967); *Swanson, supra; Coyle v. Skirvin*, 124 F.2d 934, 935-936 (10th Cir. 1942); *Pioche Mines Consolidated, Inc. v. Dolman*, 333 F.2d 257, 272-273 (9th Cir. 1964); *Tennessee Mountain Petroleum and Mining Co. v. Ayers*, 43 S.W. 744 (Tennessee 1897); *Taylor v. Holmes*, 127 U.S. 489 (1888) (dismissed only for failure to make a demand); *Watts v. Vanderbilt*, 45 F.2d 968 (2nd Cir. 1930) (dismissed only for failure to make a demand). The inequity of not allowing such proceedings has been recognized. In *Miller, supra*, 268 F.Supp. at 267-268, it was stated that ". . . a grossly inequitable decision would be reached if I were to hold that a merged corporation and/or its shareholders are barred from suing where the very merger itself took place because of the allegedly wrongful activities of the directors of the old corporation

[6] Of course, it can be said that state corporation laws on capacity to sue should not be allowed to frustrate the "overriding federal law." *Borak, supra*, 377 U.S. at 434-435. Such frustration could easily occur in cases such as this if, for example, the remedy of rescission was found to be in order but only the class action suit had been allowed to proceed. *Smallwood, supra*, 489 F.2d at 591, n. 12. It is not uncommon for otherwise applicable state law to be overriden when federal rights are essentially involved. *Borak, supra*, 377 U.S. at 434, quoting from *Textile Workers v. Lincoln Mills*, 353 U.S. 448, 457 (1957). As already noted, none of the appellate courts hearing this case questioned plaintiffs' ability to bring derivative claims; and the derivative claims were themselves recognized by the appellate courts as being an important part of this lawsuit. *Mills, supra*, 403 F.2d at 431 and 396 U.S. at 388, 392, and 395-396.

and the management of the surviving corporation among others . . .," particularly since the suit was properly brought initially. It would also be inequitable in light of: (1) the finding by the Seventh Circuit Court of Appeals that had there been sufficient time between the filing of this lawsuit and the shareholders' meeting, it is unquestionable that corrective measures would have been appropriate and that the meeting which approved the merger would not have occurred when it did, *Mills, supra*, 403 F.2d at 435; (2) the finding of the Supreme Court that the effectiveness of that meeting's approval of the merger could still be nullified by this Court even long after the merger had been consummated; and (3) the apparent necessity of allowing the derivative claims to proceed in order that this possibility of nullification would be an available remedy, *Basch, supra*, 53 F.R.D. at 12 and *Smallwood, supra*, 489 F.2d at 591, n. 12.

Even if Ohio law on capacity to sue could foreclose a derivative action under the federal securities laws, a review of Ohio law reveals no barrier to the assertion of derivative claims in this case. Plaintiffs herein filed their original complaint on June 26, 1963—a day before the Auto-Lite stockholders' meeting at which the merger terms were approved. Thus, it is beyond dispute that under Ohio law Auto-Lite possessed the capacity to sue for at least some time during the pendency of this case. It also appears that plaintiffs' request to set aside the merger was timely filed under Ohio law, if such law is applicable. Page's *Ohio Rev. Code* § 1701.81(c) (repealed eff. 7-17-70), § 1701.82(c) (eff. 7-17-70), and § 1701.83(B)(3) (repealed eff. 7-17-70).[7]

[7] Ohio corporation law existing at the time of the filing of this suit was as follows with respect to the rights of the surviving and constituent corporations after the effective date of the constituents' merger.

> ". . . any claim existing or action or proceeding pending by or against any of the constituent corporations may be prosecuted to judgment, with right of appeal as in other cases, as if such merger of consolidation had not taken

(Footnote continued on following page)

Just as Ohio statutory law presents no bar to plaintiffs' derivative claims, so too Ohio case law presents no legal barrier. Ohio courts have long recognized the inequity of foreclosing injunctive, as well as other, relief to minority shareholders of a dissolved or otherwise changed corporation when the force behind the corporate change involved fraud or the like. *Gottlief v. Mead Corporation*, 137 N.E. 2d 178, 206-207 (Ct. Common Pleas 1954); *Wick, supra*, 188 N.E. at 526; *Gen. Inv. Co., supra*, 250 F. at 174; *Johnson, supra*, 15 N.E. 2d at 132; *Ohio Nat. Life Ins. Co., supra*, 81 N.E. 2d at 625; *Goodison v. North American Securities Co.*, 178 N.E. 29 (Ohio Appls. Ct. 1931).

Defendants assert that the relief available to the plaintiffs on their derivative claims in this case is limited to the setting aside of the merger and that the plaintiffs' "derivative language" has lost all its significance. I cannot agree with such assertions. In holding that a party

[7] *continued*

> place, or the surviving or new corporation may be substituted in its place." Page's *Ohio Rev. Code* § 1701.81 (A)(6) (repealed eff. 7-17-70), made applicable by § 1701.83 (A)(3) (repealed eff. 7-17-70).

See also *McKinney's Consol. Laws of N. Y. (Ann.)*, Business Corporation Law §§ 906(b)(3) and 907(i). Since 1963, Ohio corporation law has been substantially amended; yet it still provides that Ohio corporations, although dissolved through mergers, may proceed in their own names with claims they had pending at the time of the merger. Page's *Ohio Rev. Code* § 1701.82(A)(4). Ohio law is thus dissimilar to Delaware law, where all pending causes of action of constituent corporations apparently pass to the surviving corporation. 8 *Del. Code* § 259. See also *Heit v. Tenneco, Inc.*, 319 F.Supp. 884, 886-888 (D.Del. 1970); *Basch, supra*, 53 F.R.D. at 12; and *Voege v. Ackerman*, 364 F.Supp. 72, 74 (S.D. N.Y. 1973). The Ohio statutory provision on the appraisal rights of dissenting shareholders would also not foreclose the derivative claims in this suit because of the allegations and the proof of an illegally misleading proxy statement. *Johnson v. Lamprech*, 133 Ohio St. 567, 15 N.E.2d 127, 132 (Ohio Sup. Ct. 1938), citing with approval *General Inv. Co. v. Lake Shore and M. S. Ry. Co.*, 250 F. 160, 174 (6th Cir. 1918); *Wick v. Youngstown Sheet and Tube Co.*, 46 Ohio App. 253, 188 N.E. 514, 520 (Ohio Appls. Ct. 1932); *Ohio Nat. Life Ins. Co. v. Struble*, 81 N.E.2d 622, 625-626 (Ohio Appls. Ct. 1948).

may bring a derivative suit under § 27 of the 1934 Exchange Act for violation(s) of § 14(a), the Supreme Court recognized a wide range of possible remedies, including retrospective as well as prospective relief and civil damages as well as injunctive relief. *Borak, supra*, 377 U.S. at 432 and 434. In discussing possible remedies in this particular case, the Supreme Court again recognized such a range; that Court specifically held that this Court could set aside the merger as a form of relief for the named plaintiffs suing derivatively on behalf of Auto-Lite, yet also stated that monetary relief was a possibility for the Auto-Lite shareholders if rescission was found to be contrary to their best interests. *Mills, supra*, 396 U.S. at 388. Furthermore, in holding that the named plaintiffs were entitled to an interim award of litigation expenses against Auto-Lite or its survivor, regardless of any subsequent "monetary recovery," the Supreme Court repeatedly recognized the "substantial service" which the named plaintiffs had performed for Auto-Lite and all its stockholders; therefore, the derivative character of this action was an important, if not essential, holding of the earlier Supreme Court decision. *Mills, supra*, 396 U.S. at 389-397. Thus, the decision on whether to proceed with granting relief in this case based upon the derivative claims or upon the class action claims should not be made according to the propriety of rescission, but rather it should be made in light of the nature of any duties which were breached by the issuance of the proxy statement and the nature of any injuries which arose from such breaches. *Overfield v. Pennroad Corp.*, 146 F.2d 889, 894-895 (3rd Cir. 1944); *Johnson, supra*, 296 F.Supp. at 808, *Kauffman, supra*, 434 F.2d 727; *Garner v. Pearson*, 374 F.Supp. 580, 585 (M.D. Fla. 1974); *In re Penn Central Securities Litigation*, 347 F.Supp. 1324, 1326-1327 (E.D. Pa. 1972); 15 A.L.R. Fed. 954, n. 4 at 956.

Although breaches of fiduciary duties owed to Auto-Lite stockholders and personal injuries resulting from such breaches stand as established in this case, the

record supports the position that the Auto-Lite board's failure to perform certain duties owed to the Auto-Lite corporation at the time of the merger caused injuries to Auto-Lite itself as a result of this failure. As earlier noted, the Supreme Court in *Borak, supra*, recognized that deceptive proxy solicitations normally cause only indirect damage to a corporation's stockholders while causing direct injury to the corporation itself. 377 U.S. at 432. See also *Brudney and Chirelstein, supra*, at 314-315 and 319. The Supreme Court in this very case recognized that regardless of any reliance and/or injury to individual shareholders, "corporate therapeutics" were involved and the plaintiffs' efforts to insure non-interference with the effective and appropriate process of proxy solicitation was of great benefit to the Auto-Lite corporation. *Mills, supra*, 396 U.S. at 384, 385 and 396. Since rescission has been ruled out and since a monetary award granted to Auto-Lite would inure to all who were shareholders at the time of the proxy solicitation, including the group of shareholders heretofore defined under the class action claims, it appears to me that full recovery for all compensable injuries can be had in an award under the derivative claims. To award an additional amount based upon the class action would cause a total award to exceed the "actual damages suffered." Some individual class members might receive more or less under the derivative claims than under the class claims, but the primary concern must be the total award fund from which individual awards are made. *Wolf, supra*, 477 F.2d at 478; *Schaefer v. First National Bank of Lincolnwood*, 326 F.Supp. 1186, 1193 (N.D. Ill. 1970), *appl. dism.* 465 F.2d 234 (7th Cir. 1972); *Reeder v. Mastercraft Electronics Corp.*, 363 F.Supp. 574, 581-582 (S.D. N.Y. 1973).[8]

[8] But see *Swanson, supra*, 475 F.2d at 519 and 521 (where the Court apparently awarded relief to plaintiff class members, irrespective of their subsequent disposition of ACI shares, as long as the requisite ACI shares were returned); *Swanson, supra*, 475 F.2d at 529 (J. Sprecher concurring); and *Chris-Craft, supra*, 480 F.2d at 391. Of note is the

(Footnote continued on following page)

* * * * * *

On May 29, 1963 (the mailing date of the proxy statement), the total number of outstanding shares of Auto-Lite common stock was 1,160,565. This includes 628,015 shares held by Mergenthaler and a total of 3,965 shares held by various officers and directors of American, Mergenthaler and Auto-Lite. The number of outstanding "minority" shares in Auto-Lite on that date totaled 532,550. This number includes shares held by aforesaid officers and directors. They too received the misleading statement and presumably could have been misled by it.

On June 27, 1963, the entire outstanding stock of Auto-Lite consisted of 1,160,565 shares of common stock, and the entire outstanding stock of Mergenthaler consisted of approximately 2,700,688 shares of common stock. On the next day, Eltra issued 986,170 shares of its convertible preferred stock (par value of $34.50) to holders of the then outstanding common shares of Electric Auto-Lite. This was in accord with the merger agreement. By June 27, Eltra had approximately 2,700,688 shares of common stock outstanding which belonged to the former holders of Mergenthaler's capital stock. And by September 29, 1963, Eltra had 980,534 shares of preferred stock outstanding and 2,732,794 shares of common stock outstanding.

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[8] *continued*

practical impossibility of awarding damages to each member of the plaintiffs' alleged class based upon the date of his or her disposition of Eltra stock and/or upon the date on which each member learned of the misleading nature of the proxy statement. *Chasins v. Smith, Barney & Co.*, 438 F.2d 1167, 1170 (2nd Cir. 1970); *Chelsea Associates v. Rapanos*, 376 F.Supp. 929, 943, (E.D. Mich. 1974); *Baumel v. Rosen*, 412 F.2d 571, 576 (4th Cir. 1969). It should also be noted that even though certain class members in this case may have actually sold their Eltra stock received in the exchange at a price higher than the fair market value of the Auto-Lite stock which they had exchanged for such Eltra stock, these class members will not be barred from receiving a portion of this Court's award under the derivative claims. *Wolf, supra.*

The exchange ratio employed in effectuating the merger allowed a former Mergenthaler shareholder one share of Eltra common stock for each share of Mergenthaler capital stock and allowed a former Auto-Lite shareholder one and eighty-eight-one-hundredths (1.88) shares of Eltra preferred stock for each share of Auto-Lite common stock.

Prior to readjusting this exchange ratio and therein determining the appropriate damage, this Court must first determine the relationship in the values at the merger date of one share of Eltra preferred stock and one share of Eltra common stock. Dr. Nemmers testified that the value of the Eltra convertible preferred stock at the time of the merger was $26.19 per share and that each share of Auto-Lite common stock thus returned a value of $49.24 in the exchange. The value of $26.19 was reached by adding the estimated worth of the Eltra stock as a straight preferred $25.69) to the estimated worth of the Eltra stock's conversion feature ($.50).

Professor Emmett also testified on the value of the Eltra convertible preferred stock. He estimated that this stock was worth $29.50 as a straight preferred and that it had a conversion feature worth at least $2.21. Based on these and other estimates, Emmett stated that the low value for the convertible preferred stock at the time of the merger was $31.71 per share while its highest value was $33.19 per share. According to Emmett then, each share of Auto-Lite common stock returned a value of between $59.61 and $62.50 as a result of the merger. Because he estimated the maximum value of a share of Auto-Lite common stock to be worth $55 at the time of merger, Professor Emmett concluded that the Auto-Lite shareholders undoubtedly "were paid more than what they were giving up" in the merger.

Each share of Auto-Lite common stock was actually priced at the time of the merger and for awhile thereafter in excess of $58—assuming no conversion—and in excess of $47—assuming there was conversion. Thus, Professor Emmett's rather than Professor

Nemmer's testimony was more closely borne out in the market place. Furthermore, it is clear that very few shares of preferred were converted during the 1963 and 1963 fiscal years. Finally, it can be gathered from the foregoing that nearly all former Auto-Lite minority shareholders actually received as a result of the merger, stock valued in the market place at the time of its receipt which was about 225% the market value of the stock received by the former Mergenthaler shareholders. I am of the opinion that after taking into account the nature of the Eltra stock received by each of the merging parties, the effective exchange ratio was 2.25 to 1.

Although the effective exchange ratio was 2.25 to 1 rather than 1.88 to 1, I am of the further opinion that the ratio of 2.35 to 1 represents fairly what was given up by the holder of one share of Auto-Lite stock as compared with what was given up by a holder of one share of Mergenthaler stock at the time of the merger. This opinion is based upon all of the relevant evidence introduced at trial regarding the pre-merger histories of Auto-Lite and Mergenthaler and the respective conditions of Auto-Lite and Mergenthaler in the early months of 1963.

In distributing interests in Eltra based upon a 2.25 to 1 ratio, it can be said that a former Auto-Lite minority shareholder received for each share of stock approximately 67.38% of the interest in Eltra received for one share of Auto-Lite and one share of Mergenthaler (2.25 + [2.25 + 1]). Had the interests been distributed on a 2.35 to 1 basis, a former Auto-Lite shareholder would have received for each stock share approximately 70.15% of the interest in Eltra received for one share each of Auto-Lite and Mergenthaler (2.35 + [2.35 + 1]). Thus, by the utilization of an unfair exchange ratio, each Auto-Lite shareholder was deprived of approximately 2.77% of the combined value of an Auto-Lite share and a Mergenthaler share (70.15-67.38). In July of 1963, the average value of one former share of Mergenthaler stock was $25.25 while the average value of one former share

of Auto-Lite stock was $58.39—assuming no conversion. Based upon these figures, each Auto-Lite minority shareholder may be said to have lost approximately $2.317 (.0277 x [$58.39 + $25.25]). Since there were 532,550 outstanding minority shares on May 29, 1963 and since approximately that many shares were converted into Eltra preferred shares in June, 1963, injury to the Auto-Lite minority shareholders amounts to approximately $1,233,918.35 (532,550 x $2.317). This figure would not appreciably change if the market values as of June 28, 1963 were employed. Furthermore, this figure generally conforms to the figures which I arrived at using alternative methods of calculation and amounts to what I consider to be an equitable award.

Employing the average market values of Eltra stock in July, 1963, in computing monetary damages, does not conflict with my finding that the 1958-1963 market valuations of Auto-Lite and Mergenthaler stock were unreliable. The record contains no credible evidence that these valuations were influenced so that their reliability as indicators of value would be brought into doubt. Further, if the merger generated a value for Eltra which was larger than the sum of the values for Auto-Lite and Mergenthaler, the method of computing damages based upon the post-merger market prices of Eltra stock allows the Auto-Lite minority to share in Eltra's "incremental" value. *Brudney and Chirelstein, supra,* at 313-314.

* * * * * *

Having found that Auto-Lite and its former minority shareholders are entitled to a monetary award based upon the unfairness of the merger terms, several matters yet remain. One is the source of payment of fees and costs. As stated above, the Supreme Court held (*Mills, supra,* 396 U.S. at 389-390), that the plaintiffs are entitled to an award for their "litigation expenses and reasonable attorneys' fees." This award was said to be recoverable from either Auto-Lite or its survivor, and to cover those expenses incurred up to, and including,

the time of the Supreme Court decision. The decision made no indication as to the propriety of an award for fees and costs incurred subsequent to the time of the Court's decision. What the Supreme Court stated was that any future actions before this or any other Court could not serve to alter the interim award of expenses, although plaintiffs' success in future proceedings might be a factor in determining whether a further award would be appropriate. (396 U.S. at 396).

It may well be that so much of counsel fees and expenses as were incurred in establishing liability in this case could be assessed against the defendants, independent of the damage award based upon the merger's unfairness. *Gerstle, supra*, 478 F.2d at 1308-1309 and at 1310-1311 (J. Oaks concurring). Or it may even be that all of the plaintiffs' costs can be independently assessed against the defendants without the traditional showing of bad faith. *Swanson, supra*, 475 F.2d at 521 and at 529 (J. Sprecher dissenting, in part). [But in *Swanson* there was only a "modest recovery achieved", 475 F.2d at 521]. See also *Ojeda v. Hickney*, 452 F.2d 947, 948 (5th Cir. 1972); *Oppenlander v. Standard Oil Co. of Indiana*, 64 F.R.D. 597 (D.Col. 1974); and *Dillon v. Berg*, 351 F.Supp. 584 (D.Del. 1972). After carefully reviewing relevant considerations and case law, I conclude that the plaintiffs should recover all of their litigation expenses—including those incurred prior to the finding of liability—out of the damages awarded to Auto-Lite and its former shareholders. *Gerstle, supra*, 478 F.2d at 1311. This ruling runs counter to no applicable federal statute on mandatory or permissive fee shifting. *Mills, supra*, 396 U.S. at 390; "The Allocation of Attorney's Fees after *Mills*", 38 *U. Chicago L. Rev.* 316, 324 (Winter 1971). It also is supported by my finding that the defendants have not acted in bad faith, vexatiously, wantonly or for oppressive reasons. *Hall v. Cole*, 412 U.S. 1, 5 (1973) and cases cited therein; see also *Gerstle, supra*, 478 F.2d at 1309, n.33. Nor have defendants acted frivolously. *Gerstle, supra*, 478 F.2d at 1309, n. 33. The Supreme Court recognized that the individual plaintiffs

should be reimbursed "by the corporation" and that the costs normally ought to be imposed upon "the party that has benefited from them and that would have had to pay them had it brought the suit." *Mills, supra*, 396 U.S. at 390 and at 396-397. See also *Hall, supra*, 412 U.S. at 5-7 and *Chaney v. Western States Title Ins. Co.*, 292 F.Supp. 376, 379 (D.Utah 1968).

The extraction of litigation expenses from the monetary award made to Auto-Lite would not serve to hamper any Congressional purpose in its enactment of the various federal securities laws involved. *Gerstle, supra*, 478 F.2d at 1310-1311 (J. Oaks) and *Grace v. Ludwig*, 484 F.2d 1262, 1267 (2nd Cir. 1973). For example, competent counsel will not be discouraged from accepting representation in future § 14(a) cases since, presumedly, all the plaintiffs' attorneys involved in this litigation will be fairly compensated. *Oppenlander, supra*, 64 F.R.D. at 613. Furthermore, such extraction conforms with traditional judicial notions on the awarding of counsel fees and expenses in derivative suits where an ample fund has been generated. *Gerstle*, 478 F.2d at 1309. And such an extraction would eliminate the "punitive" aspects of the fee shifting, *Hall, supra*, 412 U.S. at 5, and would not "saddle the unsuccessful party with the expenses", *Mills, supra*, 396 U.S. at 396. Finally, such an extraction should not serve as a disincentive to future plaintiffs since named plaintiffs in derivative and/or class action securities cases often expect and receive only modest recovery, *Oppenlander, supra*, 64 F.R.D. at 614.

Accordingly, supplementary proceedings will be necessary in this case to determine the fair amount of attorneys' fees and other expenses incurred by plaintiffs.

A second remaining matter involves plaintiffs' request that punitive damages be assessed. Since, as the parties apparently agree, all counts of the complaint have been tried, this request properly is now before me.

It is urged that such a request ought be granted since the common law claim is found to have merit.[9]

Count I alleges common law fraud. The elements of a cause of action for fraud and deceit have been described in this District as follows: "There must be (1) a false representation of (2) a material (3) fact; (4) the defendant must know of the falsity (scienter) but make the statement nevertheless for the purpose of inducing the plaintiff to rely on it; (5) the plaintiff must justifiably rely on it; and (6) the plaintiff must have suffered damage as a consequence." *Burkhart, supra*, 363 F.Supp. at 1291. But according to *Burkhart*, to recover punitive damages for common law fraud, plaintiff needs to prove that the false representations were wantonly and designedly made. Ohio courts have required proof of malice before allowing punitive damages. *Burnett v. Sebel*, 150 N.E. 2d 304, 306 (Ohio Ct. Appls. 1958); *Wilchins v. Pool*, 29 Ohio App. 2d 223, 280 N.E. 2d 396, 399 (Ohio Ct. Appls. 1971).

I am of the opinion that in this case there is no evidentiary nor equitable basis for awarding punitive damges. No showing of "gross and malicious fraud" has been made. *Wilchins, supra*, 280 N.E. 2d at 399. I am par-

[9] See: "Comment: The Reappearance of Punitive Damages in Private Actions for Securities Fraud", 5 *Tex. Tech L. Rev.* 111 (Fall 1973); "§ 28(a) of the Securities Exchange Act: Punitive Damages and Pendent State Claims", 46 *U. Colorado L. Rev.* 59 (Fall 1974); *Flaks v. Koegel*, 504 F.2d 702, 706-707 (2nd Cir. 1974); *Coffee v. Permian Corp.*, 474 F.2d 1040, 1044-1045 (5th Cir. 1973), *cert. den.* 93 S. Ct. 2736 (1973); *Young v. Taylor*, 466 F.2d 1329 (10th Cir. 1972); *In re Caesars Palace Securities Litigation*, 360 F.Supp. 366, 394 (S.D. N.Y. 1973); *Burkhart v. Allson Realty Trust*, 363 F.Supp. 1286, 1290-1292 (N.D. Ill. 1973). See also *de Haas v. Empire Petroleum Co.*, 302 F.Supp. 647 (D.Col. 1969), *rev'd in this part*, 435 F.2d 1223, 1229-1232 (10th Cir. 1970) [where no common law claims appear to be present] and *Green v. Wolf Corp.*, 406 F.2d 291, 302-303 (6th Cir. 1969) [where no common law claims appear to be present]. But see *Schaefer v. First National Bank of Lincolnwood*, 326 F.Supp. 1186, 1192-1193 (N.D. Ill. 1970), *app'l dismissed* 465 F.2d 234 (7th Cir. 1972).

ticularly impressed by evidence presented by the defendants on the issue of good faith during the formation and adoption of the merger terms, by the lack of any substantial evidence showing actual malice, and by the nature of the securities law violation charged in Count II. My opinion on Count I would remain unchanged even if Illinois or New york common law, rather than Ohio common law were applied. *Davis v. Avco Corp.*, 371 F.Supp. 782, 789 (N.D. Ohio 1974); *Herzfeld, supra*, 378 F.Supp. at 131; *Roda v. Berko*, 401 Ill. 335, 339-40, 81 N.E. 2d 912, 914 (1948). Whether punitive damages can be recovered under Count III is foreclosed by my opinion.

A third remaining matter involves the propriety of allowing pre-judgment and post-judgment interest on the monetary award. Section 3 of Chapter 74 of the Illinois Revised Statutes provides a statutory "appropriate" rate. *Cant v. Becker & Co., Inc.*, 379 F.Supp. 972, 974 (N.D. Ill. 1974); *Chicago, R. I. & P. R. Co. v. Chicago, B. & Q. R. Co.*, 55 F.R.D. 209, 210 (N.D. Ill. 1972); 28 U.S.C. § 1961.

The law is settled that pre-judgment interest is within the Court's discretion, since the Exchange Act is silent on the issue. (Compare 15 U.S.C. § 771 with 15 U.S.C. § 78bb. See also *Royal Indemnity Co. v. U.S.*, 313 U.S. 289, 296 (1941); *Rodgers v. U.S.*, 332 U.S. 371, 373-374 (1947); and *Speed, supra*, 235 F.2d at 374). Even if the award were based upon charges of common law fraud, pre-judgment interest is discretionary. *Smith v. Dravo Corp.*, 208 F.2d 388, 391 (7th Cir. 1953).

Pre-judgment interest is said to be more likely in § 10(b) cases than in § 16(b) cases, since § 10(b) involves a necessary finding of a "manipulative or deceptive device or contrivance" while § 16(b) involves only a finding of a certain type of profit—regardless of the profiteer's intention. Thus, a showing of "good faith" by a § 16(b) violator may preclude a pre-judgment interest allowance. *Blau v. Lehman*, 368 U.S. 403, 414 (1962); *Gold v. Sloan*, 486 F.2d 340, 353 (4th Cir. 1973), *reh. den.*

491 F.2d 729 (4th Cir. 1974); *Allis-Chalmers Mfg. Co. v. Gulf & Western Industries, Inc.*, 372 F.Supp. 570, 590 (N.D. Ill. 1974); *Marquette Cement Mfg. Co. v. Andreas*, 239 F.Supp. 962, 968 (S.D. N.Y. 1965). Yet a similar showing of "good faith" by a § 10(b) violator may not preclude pre-judgment interest. *Herzfeld, supra*, 378 F.Supp. at 129, n. 31; *Chasins v. Smith, Barney & Co.*, 438 F.2d 1167, 1170 and 1173 (2nd Cir. 1970); *Norte, supra*, 304 F.Supp. at 1111; *Speed, supra*, 235 F.2d at 374; *Swanson, supra*, 475 F.2d at 521 [where the Seventh Circuit Court of Appeals awarded pre-judgment interest covering a span of seven years, although the merger terms involved were found to be fair] and at 529 [where a dissenting judge would have awarded pre-judgment interest covering a seven year span on an award based upon unfairness of the merger terms].[10]

I conclude that an award of pre-judgment interest is appropriate in this case. At most, the inequity of awarding a high rate of interest, is found in the following

[10] My own crucial distinction between § 10(b) and § 16(b) cases is implicit in the following:

> "I am of the further opinion that the concept of interest in 16(b) cases offends logic. Since interest represents "the wages of money (or money measured values) at work", it ought be treated as such. If one wrongfully is deprived of the use of money in which one has a proprietary right, the wrongdoer should return it together with the wages it reasonably could have earned throughout the period its owner could have put it to work. The purchaser of stock of a corporation, issued and outstanding, is not taking from the corporation itself values which the corporation could itself have put to work. It is conceivable that the diving in and out by a short-swing profiteer can injure the corporation. I find no support for the idea that relating the profit to the injury would be measuring comparables. A corporation's relationship to its issued and outstanding stock is fiduciary. When a stockholder transfers his stock to another, the corporation's relationship remains in tact. The corporation itself has been deprived of nothing." *Allis-Chalmers, supra*, 372 F.Supp. at 589-590.

Clearly, plaintiffs here had a proprietary right in the use of full value of its Auto-Lite shares at the time of the merger; as earlier indicated, that full value was not received since the exchange ratio overvalued Mergenthaler capital stock in relation to Auto-Lite common stock.

observations. First, the violation of § 14(a) to a large extent involved a failure to provide sufficient emphasis in the proxy statement on the interrelationship of the Auto-Lite and Mergenthaler boards; yet, the proxy statement did contain ". . . information which would indicate to those aware of corporate mechanism that Mergenthaler had the power to select a majority, if not all, the members of the (Auto-Lite) board and may well have exercised it, and that a minority, at least, were directors of both (Auto-Lite and Mergenthaler)." *Mills, supra*, 403 F.2d at 433. Second, other misleading aspects of the proxy solicitation did not relate to the terms of the merger itself. *Mills, supra*, 396 U.S. at 389. Third, as noted earlier with respect to the matter of punitive damages, there is no significant direct evidence of the defendants' malice or bad faith. The violation was not clearly, and without a doubt, "manipulative or deceptive."

Further, consideration must be given to the conduct of the defendants during the long history of this case. Very little, if any, delay in these proceedings was caused by the defendants. Compare *Gerstle, supra*, 348 F.Supp. at 981-982, where pre-judgment interest was awarded, 478 F.2d at 1310. See also *Pearlstein v. Scudder & German*, 346 F.Supp. 443, 454-455 (S.D. N.Y. 1972) and *Shinki Boeki Co., Ltd. v. SS Pioneer Moon*, 378 F.Supp. 418, 419 (S.D. N.Y. 1974). Also worthy of consideration is the fact that this case "primarily involved an issue of law which was novel at the time the suit was commenced." *Hodgson v. American Can Co.*, 317 F.Supp. 152, 161 (W.D. Ark. 1970), *rev'd.* 440 F.2d 916 (8th Cir. 1971). See also *Allis-Chalmers, supra*, and *Speed, supra*, 135 F.Supp. at 199.

On the other hand, Auto-Lite and its former shareholders were deprived of a certain percentage of the ownership in Eltra on the date on which the exchange ratio took effect. Deprivation on this percentage of ownership is stated in terms a loss of money at the time of the merger.

In this case, I have attempted by an award of damages to compensate Auto-Lite and its former shareholders for the value of the interest in Eltra which they did not receive at the time of the merger. Granting pre-judgment interest on this award cannot, however, be equated with compensating for the loss of what the petitioners would have earned between 1963 and 1975 by themselves putting to work the money value of this interest in Eltra. Many former Auto-Lite shareholders continued to hold Eltra stock long after the merger. Much of this holding would have occurred even if Auto-Lite and its shareholders had been granted a full and fair interest in Eltra at the time of the merger. Determining the loss of earnings from 1963 to this date on the value of the interest in Eltra which Auto-Lite and its shareholders did not receive actually depends, in large part, upon the dividends on the interest in Eltra which the former Auto-Lite shareholders did not receive prior to the sale—if sold—of their shares in Eltra, the difference in the market value of the interest in Eltra which was actually sold and of the interest in Eltra which would have been sold by the former Auto-Lite shareholders had the merger been fair, and the loss of what the sum of these lost dividends and market value differences would have earned for each of the former Auto-Lite shareholders from the date of the sale of their shares in Eltra to this date of judgment. Although the former Auto-Lite shareholders did not lose the ability to utilize an actual liquidated sum between the merger date and the judgment date, they have lost some "wages". *Allis-Chalmers, supra*, 372 F.Supp. at 589. But this has not been the full of the traditional loss of "wages" since the value which was denied to the petitioners was maintained in Eltra and put to use for all owners of Eltra—including the petitioners.

Taking into account these observations, I conclude that interest at the rate of 5% per annum should be awarded and that this interest should not be compounded. Such an award, in my opinion, allows petitioners full compensation without an accidental windfall

of interest.[11] In setting a 5% rate, I have given consideration to Illinois law on interest awards. *Ill. Rev. Stat.* ch. 74, § 3; *Royal Indemnity Co., supra*, 313 U.S. at 297; *Pearlstein, supra*, 346 F.Supp. at 454; *Collier v. Granger*, 258 F.Supp. 717, 719 (S.D. N.Y. 1966); and *Chaney, supra*, 292 F.Supp. at 380.

ORDER

The Clerk of the Court is directed to enter judgment in favor of the plaintiffs and against the defendants in the amount of $1,233,918.35, together with straight interest thereon at the rate of 5% per annum from June 28, 1963 to the date of judgment herein.

ENTER:

/s/ James B. Parsons
James B. Parsons
United States District Judge

DATE: April 11, 1975

[11] On compound interest, see Speed, supra, 135 F.Supp. at 199; *Cherokee Nation v. U.S.*, 270 U.S. 476, 490 (1926); *SCA International, Inc. v. Garfield & Rosen, Inc.*, 337 F.Supp. 246, 249 (D. Mass. 1971); *U.S. v. Glasser*, 287 F.2d 433, 434 (7th Cir. 1961).

APPENDIX D

STATUTES & RULES INVOLVED

SECURITIES EXCHANGE ACT OF 1934, §§ 14(a), 28(a)
15 U.S.C. §§ 78n(a), bb(a).

§ 78n. Proxies.

(a) It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 78*l* of this title.

§ 78bb. Effect on existing law—Addition of rights and remedies; recovery of actual damages; State securities commissions.

(a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. Nothing in this chapter shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of this chapter or the rules and regulations thereunder.

SECURITIES AND EXCHANGE COMMISSION
RULE 14a-9(a) 17 C.F.R. § 240.14a-9(a)

§ 240.14a-9 False or misleading statements.

(a) No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.